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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

H. C. GOWRAN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 12, 1937

CERTIORARI GRANTED MAY 17, 1937

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 60890

H. C. GOWRAN, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: A. L. Nash, Esq. For Comm'r.: J. E. Marshall, Esq., I. Graff, Esq., H. D. Thomas, Esq.

Docket entries

Transferred to Mr. Leech 2/19/34

1931

Dec. 16—Petition received and filed. Taxpayer notified. (Fee paid.)
Dec. 17—Copy of petition served on General Counsel.

1932

Feb. 5—Answer filed by General Counsel.
Feb. 12—Copy of answer served on taxpayer—assigned to General Calendar.
Feb. 23—Order to place on Circuit Calendar for hearing in Milwaukee, Wis. entered.
Jun. 13—Notice of hearing beginning July 25, 1932 at Milwaukee, Wis.
Jul. 26—Hearing had before S. J. McMahon, Div. 16. Submitted on merits. Consolidated for hearing and order with dockets 60891, 2 & 3. Stipulation of facts filed. Brief due 12/15/32—15 days thereafter for replies. Called July 25, 1932.
Aug. 15—Transcript of hearing July 25, 26, 1932 filed.
Dec. 15—Brief filed by taxpayer.

1933

Jun. 29—Memorandum opinion rendered, Stephen J. McMahon, Div. 6. Decision will be entered under Rule 50.
Jul. 18—Motion to reconsider memo opinion and for review by Board filed by General Counsel.
2 Jul. 24—Order that motion for reconsideration be denied entered.
Jul. 26—Hearing set August 28, 1933 at Chicago, Ill. on motion.
Aug. 28—Hearing had before Mr. McMahon, Div. 16. Submitted on motion of respondent to reconsider judgment for the respondent. Briefs due 9/20/33.
Sep. 20—Brief filed by taxpayer.

Sep. 18—Transcript of hearing 8/28/33 filed.

Sep. 22—Motion for extension of time to Oct. 20, 1933, to file brief filed by General Counsel. 9/22/33 granted.

Oct. 19—Memorandum brief filed by General Counsel.

1934

Jan. 15—Order that motion of respondent for reconsideration of memorandum opinion be denied entered.

Jan. 26—Motion for review by Board filed by General Counsel.

Jan. 31—Order that order with accompanying memorandum dated Jan. 16, 1934, be reviewed by the Board entered.

Nov. 20—Order vacating order dated Jan. 15, 1934, and further ordered that motion for reconsideration of memorandum opinion be granted entered.

Nov. 24—Order placing on the next Chicago, Ill. Circuit Calendar for further hearing entered.

Dec. 27—Hearing set week of Feb. 4, 1935, at Chicago, Ill.

1935

Feb. 13—Hearing had before Mr. Leech—one addition issue heard before Mr. Trammell. Submitted on merits. Motion for judgment filed. Briefs due—petitioner's 3/15/35—respondent's 4/1/35—petitioner's reply 4/12/35.

Feb. 20—Transcript of hearing of 2/13/35 filed.

Mar. 15—Brief filed by taxpayer. 3/15/35 copy served.

Mar. 30—Memorandum reply brief filed by General Counsel.

Apr. 13—Order extending time to April 15, 1935, to file reply brief entered.

Apr. 13—Reply brief filed by taxpayer.

Apr. 16—Copy of order and reply brief served.

Jun. 27—Opinion rendered, J. Russell Leech. Decision pursuant to Rule 50.

Jun. 27—Motion for judgment denied.

Jul. 19—Notice of settlement filed by General Counsel.

Jul. 22—Hearing set August 7, 1935, on settlement.

Aug. 7—Hearing had before Mr. Black (Leech) on settlement under Rule 50. (Letter from petitioner) not contested. Div. 15 for decision.

Aug. 9—Decision entered, Div. 15, Eugene Black.

Sep. 20—Motion to fix amount of bond filed by taxpayer.

Sep. 21—Order fixing amount of bond at $8,700 entered.

Nov. 8—Supersedeas bond in the amount of $8,700.00 approved and ordered filed.

Nov. 8—Petition for review by U. S. Circuit Court of Appeals (7) with assignments of errors filed by taxpayer.

Nov. 8—Proof of service filed by taxpayer.

Dec. 26—Motion for extension to Feb. 6, 1935, to transmit and deliver record filed by taxpayer.

Dec. 26—Order enlarging time to Feb. 6, 1936, to complete and transmit record entered.

1936

Jan. 22—Praecipe with proof of service thereon filed by taxpayer.

Feb. 3—Motion for extension to March 7, 1936, to transmit and deliver record filed by taxpayer.

Feb. 3—Order extending time to March 7, 1936, to transmit and deliver record entered.

Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed Dec. 16, 1931

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated October 19, 1931, and further identified by the symbols

IT:AR:D-2

MR-60D

and as a basis of his proceeding alleges as follows:

4 1. The petitioner is an individual, residing at 2403 Jefferson Street in the city of Two Rivers, Wisconsin.

2. The notice of deficiency and accompanying statement (copies of which are attached and marked Exhibit A) were mailed to the petitioner on October 19, 1931.

3. The deficiency by the Commissioner amounts to Five Thousand Eight Hundred Thirty-one and 67/100 Dollars ($5,831.67), being income taxes for the calendar year 1929, and the total amount of such deficiency is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

(1) The Commissioner erroneously found that the stock dividend of 533.715 shares of preferred stock which Hamilton Manufacturing Company distributed to petitioner on July 1, 1929, was redeemed by the company in such manner as to make the transaction equivalent to the distribution of a taxable dividend.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(1) On July 1, 1929, Hamilton Manufacturing Company, a Wisconsin corporation, hereinafter called the Company, distributed a stock dividend to its common stockholders, amounting to Fourteen Dollars ($14.00) per share on the shares of common stock then outstanding. The dividend was paid entirely in shares of the Com-

pany's preferred stock at its par value of One Hundred Dollars ($100.00) per share.

(2) Petitioner received 533.715 shares of the Company's preferred stock at its par value as his share of the dividend.

(3) Every other common stockholder of the Company besides petitioner received the same pro rata distribution of preferred stock as did petitioner.

(4) The dividend was payable solely in preferred stock of the company, and no stockholder had any election, option, or right to receive anything except such preferred stock in payment of the dividend; there was no representation by the Company to any stockholder at any time that any part of the dividend shares would ever be redeemed in cash.

(5) Petitioner sold his shares of dividend stock to the Company about three months after the distribution for Fifty-three Thousand Three Hundred Seventy-one and 50/100 Dollars ($53.371.50), this amount being the par value of the dividend shares received, without the redemption premiums of $5.00 per share provided for by the Company's articles of incorporation in case of actual redemption by the Company.

(6) At the time petitioner sold his dividend stock to the company, neither he nor any other stockholder had any contract right to receive any sum of money from the Company in exchange for the dividend shares.

(7) The stock distributed in the dividend of July 1, 1929, was not all sold to the Company by the owners thereof after said date. There was no purchase or redemption of the dividend stock pro rata from all the stockholders.

(8) The purpose of the Company in purchasing petitioner's dividend stock was primarily to secure additional preferred stock for sale to its employes, and not to effect a distribution of cash to petitioner.

(9) The transaction here described was not in any sense a redemption of its preferred stock by the company.

Wherefore, the petitioner prays that this Board may hear the proceeding and review and reverse the findings of the Commissioner of Internal Revenue complained of above and set aside the Commissioner's determination of deficiency as set forth in his notice of deficiency dated October 19, 1931, and grant the petitioner such other and further relief as he may be entitled to in the premises.

H. C. Gowran,
H. C. Gowran,
2403 Washington Street, Two Rivers, Wisconsin.
A. L. Nash,
Attorney for Petitioner,
Post Office Address:
Manitowoc Savings Bank Bldg., Manitowoc, Wisconsin.

[*Duly sworn to by H. C. Gowran, jurat omitted in printing.*]

6 *Exhibit A to petition*

TREASURY DEPARTMENT,
Washington, Oct. 19, 1931.

Mr. H. C. GOWRAN,
2403 Jefferson Street, Two Rivers, Wisconsin.

SIR: You are advised that the determination of your tax liability for the year(s) 1929 discloses a deficiency of $5,831.67, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, If You Do Not Desire To Petition, you are requested to execute the inclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; Whereas If No Agreement Is Filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNETT,
Commissioner.
By J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.

7 STATEMENT

IT:AR:D-2
MR-60D
In re: Mr. H. C. GOWRAN,
2403 Jefferson Street, Two Rivers, Wisconsin.

TAX LIABILITY

Year 1929; Tax Liability $14,686.91; Tax Assessed $8,855.24; Deficiency $5,831.67.

Reference is made to the report of the internal revenue agent in charge and to your protest dated March 24, 1931.

Careful consideration has been given the information furnished in your protest and also during the conference held in this office on August 7, 1931 with your representative, Mr. A. L. Nash.

The facts indicate that on July 1, 1929, the Hamilton Manufacturing Company, distributed to you a stock dividend of 533.715 shares paid in preferred stock of the company and that each share had a par value of $100.00. The facts further indicate that you returned this stock to the company on October 1, 1929 and received therefor $100.00 per share in cash.

Section 115 (g) of the Revenue Act of 1928 provides:

"If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend."

Article 629 of Regulations 74 provides that the question of whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case.

The information indicates that the redemption of stock by the corporation is essentially equivalent to the distribution of a
8 taxable dividend. Your contention that the dividend of July 1, 1929, payable in preferred stock was purely a stock dividend has accordingly been denied.

Ordinary net income reported		$49,728.53
Capital net gain		47,161.62
Total net income reported		$96,890.15
Add:		
1. Increase in dividends		53,371.50
Total		$150,261.65
Deduct:		
2. Profit on Hamilton Manufacturing Company preferred stock eliminated	$445.47	
3. Decrease in capital net gain	27,262.72	27,708.19
Net income as adjusted		$122,553.46

COMPUTATION OF TAX

Total net income adjusted		$122,553.46
Less:		
Capital net gain included		19,898.90
Ordinary net income adjusted		$102,654.56
Less:		
Dividends	$94,331.50	
Personal exemption and credit for dependents	3,500.00	97,831.50
Net income subject to normal tax		$4,823.06
Normal tax at ½% on $4,000.00		20.00
Normal tax at 2% on $823.06		16.46
Surtax on $102,654.56		12,190.91
Tax at 12½% on $19,898.90		2,487.36
Total		$14,714.73

Brought forward		$14,714.73
Less:		
Earned income credit	$20.62	
Tax paid at source	7.20	27.82
Tax liability		$14,686.91
Tax previously assessed		8,855.24
Deficiency		$5,831.67

COMPUTATION OF EARNED INCOME CREDIT

Earned net income	$14,300.00
Less:	
Personal exemption and credit for dependents	3,500.00
Income subject to normal tax	$10,800.00
Normal tax at ½% on $4,000.00	20.00
Normal tax at 2% on $4,000.00	80.00
Normal tax at 4% on $2,800.00	112.00
Surtax on $14,300.00	46.00
Total tax	$258.00
Credit of 25% (limited to 25% of normal tax on ordinary net income, plus 25% of surtax on earned net income)	$20.62

EXPLANATION OF CHANGES

1. The amount realized on the redemption of 553.715 shares of Hamilton Manufacturing Company preferred stock is held to be essentially equivalent to a taxable dividend as explained in the foregoing statements.

2. Profits on sale of securities, etc., has been decreased by the profit realized on the redemption of Hamilton Manufacturing Company preferred stock.

3. Profit realized on the redemption of Hamilton Manufacturing Company preferred stock has been eliminated from capital net gain.

A copy of this letter is being forwarded to Mr. A. L. Nash in accordance with the authority conferred upon him in the power of attorney executed by you and now on file in this office.

10 Before United States Board of Tax Appeals

(Caption—60890)

Answer

Filed Feb. 5, 1932

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1, 2, and 3. Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.

4. Denies error in the action recited in paragraph 4 of the petition.

5. Denies each and every allegation of fact contained in subparagraphs (1) to (9) inclusive, of paragraph 5 of the petition which is

inconsistent with and contrary to the determination of the Commissioner as stated in the notice of final determination of a deficiency dated October 19, 1931.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Board redetermine the amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, plus any additional amount which may arise from the correction of any error or errors that may have been committed by the Commissioner. Claim is hereby asserted for the increased deficiency, if any, resulting from such determination.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
BERNARD D. HATHCOCK,
Special Attorney, Bureau of Internal Revenue.
reb. 1-26-32.

11 Before United States Board of Tax Appeals

(Docket No. 60890)

H. C. GOWRAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(Docket No. 60891)

EDITH ROSE SUDDARD, AS EXECUTRIX OF THE ESTATE OF THOMES W. SUDDARD, DECEASED, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(Docket No. 60892)

GEORGE S. HAMILTON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(Docket No. 60893)

EDWARD P. HAMILTON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Stipulation of facts

Filed at Hearing July 26, 1932

Subject to the right to offer other and further testimony not inconsistent herewith, the parties to the above styled proceedings, by their

respective attorneys of record, hereby stipulate and agree that the following facts are true:

(1) Hamilton Manufacturing Company (hereinafter referred to as the company) is a corporation organized under the laws of Wisconsin on February 23, 1926, having its principal office and place of business at the City of Two Rivers, Wisconsin. Article III of its "Articles of Organization" is as follows:

"The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

Ten thousand (10,000) shares of said stock, with a par
12 value of One Hundred Dollars ($100) per share, aggregating One Million Dollars ($1,000,000.00), shall be preferred stock and bear a preferential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and fifteen thousand (15,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock.

The holders of shares of said common stock without nominal or par value shall be entitled to all the rights and powers with relation to said stock, and with relation to their right to vote in stockholders' meetings and with relation to choosing directors, which are conferred on stockholders by law and by these Articles of Organization and by the By-Laws of the corporation; and wherever by these Articles of Organization rights and privileges are granted to stockholders or restrictions or limitations are placed upon stockholders, it is hereby declared that only the holders of the common stock are meant unless specifically designated otherwise.

The common stock without nominal or par value may be issued by the corporation from time to time, for such consideration as may be fixed from time to time by the Board of Directors thereof.

Dividends at the rate of seven per cent (7%) per annum may be paid by the corporation on its outstanding preferred stock, if the net profits of the corporation shall be sufficient therefor, and may be paid, at the option of the directors, semi-annually or quarterly. The common stock shall not receive dividends for any year unless seven per cent. (7%) shall first be paid for that year on the par value of all the preferred stock then outstanding together with all arrears of dividends on preferred stock at the like rate for previous years; but when seven per cent. (7%) shall have been paid for any year upon the par value of such preferred stock, together with all arrears of dividends at the like rate for previous years, the residue of the net profits of the corporation may then be distributed as dividends ratably to the holders of the common stock. Dividends on either preferred or common stock shall in no case be paid out of corporate assets not accruing from profits.

Upon the liquidation or dissolution or winding up of said corporation (whether voluntary or involuntary) the pre-
13 ferred stock shall be entitled to receive out of the assets of the corporation in money or in money's worth the face or par value of the preferred stock then issued and outstanding, and no more; but if upon such liquidation, dissolution or winding up, the corporation shall have, after payment of all its debts and obligations, assets which have accrued from profits the preferred stock shall be entitled to receive out of assets which have accrued from profits (but not out of other assets) payment of all of the seven per cent. (7%) annual dividends which may then be in arrears but no more. Thereafter the residue of the funds and assets of the corporation shall be divided equally among the shares of common stock then issued and outstanding.

The corporation shall have the right to purchase and redeem any part or all of said preferred stock on January first or July first in any year, by paying for each share of such preferred stock the sum of One Hundred Two and 50/100 Dollars ($102.50) together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock, when so redeemed by the corporation, shall be cancelled, but may be again sold and new certificates therefor issued."

The holders of preferred stock in said corporation shall have no vote in the meetings of its stockholders nor in choosing directors nor otherwise in the management of the corporation.

All certificates evidencing issues of either preferred stock or common stock of the corporation shall bear on the face thereof a statement of all privileges accorded to and all restrictions imposed on the preferred stock of the corporation.

The corporation may fix a fiscal year by By-Law, which may or may not be identical with the calendar year; and all computations of profits for the purpose of determining whether or not dividends are payable, and to what amount, shall be made upon the profits of each recurring fiscal year if a fiscal year shall be fixed as herein provided, otherwise upon profits of each recurring calendar year."

On April 5, 1926, the seventh paragraph of Article III of the "Articles of Organization" was amended to read as follows:

"The corporation shall have the right to purchase and re-
14 deem any part or all of said preferred stock on January first or July first in any year, by paying for each share of such preferred stock the sum of One Hundred Five Dollars ($105.00), together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention

to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock when so redeemed by the corporation, shall be canceled, but may be again sold and new certificates therefor issued."

On December 27, 1928, Article III of the "Articles of Organization" was further amended by striking out the first two paragraphs thereof and inserting in their stead the following two paragraphs:

"The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

Ten thousand (10,000) shares of said stock, with a par value of One Hundred Dollars ($100) per share, aggregating One Million Dollars ($1,000,000.00), shall be preferred stock and bear a preferential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and thirty thousand (30,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock."

(2) On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by thirty individuals in amounts ranging from 1 share to 6189 shares, the petitioners' holdings thereof being as follows:

H. C. Gowran	3812.25 shares.
Thomas W. Suddard	2833.8 shares.
George S. Hamilton	6189 shares.
Edward P. Hamilton	1619.25 shares.

The four petitioners were holders of common stock of the company throughout the year 1929.

(3) On and up to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7,155 shares, held by approximately 300 individual stockholders, the petitioners holding no shares of preferred capital stock prior to July 1, 1929.

15 (4) On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

(5) At a special meeting of the Board of Directors of the company held on June 29, 1929, the following transpired:

"On this date at eleven o'clock A. M. the Board of Directors of Hamilton Manufacturing Company, convened pursuant to consent of all directors.

"Director E. P. Hamilton duly offered the following resolution and upon motion made and seconded, it was unanimously adopted by the Board:

"Whereas, on the date of this special meeting of the Board of Directors of Hamilton Manufacturing Company, to-wit: June 29, 1929, the surplus of the company is in excess of $261,531.20; and

"Whereas, the company can at the present time lawfully declare and distribute a dividend to the holders of its common capital stock, in the sum of $261,531.20; and

"Whereas, the outstanding common capital stock of the company on this date is 18,680.8 shares, and a dividend of $14.00 per share on all of said common capital stock would amount in all to $261,531.20; and

"Whereas, of the authorized preferred stock of the company, amounting to 10,000 shares at $100.00 per share, or $1,000,000.00 in all, there remain unissued 2,616 shares or more, having a par value of $261,600.00, which unissued shares of preferred stock are available for issue by way of a stock dividend; and

"Whereas, it is for the best interests of the company and its stockholders that a dividend of $14.00 per share be declared and paid at this time on all of the issued and outstanding common capital stock of the company, the same to be paid, however, in the preferred stock of the company, computed at the par value thereof, viz: $100.00 per share; now therefore

"Resolved, by the Board of Directors of Hamilton Manufacturing Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz: $100.00.

16 "Resolved Further, that in distributing the stock dividend hereby declared, no fractional shares of preferred stock be made use of, and that the treasurer of the company be, and he hereby is, directed to adjust with each stockholder, by cash payments (from the stockholder to the company, or from the company to the stockholder, as the case may be), any fractional share by which the company has overpaid or underpaid such stockholder.

"There being no further business to come before the Board of Directors, the meeting was adjourned sine die.

"THOS. W. SUDDARD, *Secretary.*

"Attest:
"J. E. HAMILTON,
"H. C. GOWRAN,
"GEO. S. HAMILTON,
"THOS. W. SUDDARD,
"E. P. HAMILTON,
"Directors."

(6) Pursuant to the foregoing resolution, a stock dividend was paid in shares of the company's preferred stock of the par value of $100.00 per share.

(7) Said stock dividend amounted to $14.00 on every share of common stock then outstanding, or $261,531.20 in all (18,680.8 x $14.00); and the same was paid to common stockholders by the distribution to them on July 1, 1929, of 2,615,312 shares of the company's preferred stock.

(8) H. C. Gowran, the owner of 3,812.25 shares of common stock, was entitled to, and did receive 533,715 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(9) Thomas W. Suddard (now represented by Edith Rose Suddard, Executrix), the owner of 2,833.8 shares of common stock, was entitled to, and did receive 396,732 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(10) George S. Hamilton, the owner of 6,189 shares of common stock, was entitled to, and did receive 866.46 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(11) Edward P. Hamilton, the owner of 1,619.25 shares of
17 common stock, was entitled to, and did receive 226.695 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(12) Throughout the year 1929, the officers of the company were as follows: George S. Hamilton, President; H. C. Gowran, Vice-president; Thomas W. Suddard, Secretary; and Edward J. Hamilton, Treasurer; and these four individuals, together with J. E. Hamilton, constituted the Board of Directors of the company.

A. L. NASH,
Counsel for Petitioner.
C. M. CHAREST,
J. E. M.
Counsel for Respondent.

18 Before United States Board of Tax Appeals

Docket No. 60890
Docket No. 60891
Docket No. 60892
Docket No. 60893

[Title omitted]

Memorandum opinion

Received June 29, 1933. Report and Determination of Division 16

Filed June 29, 1933

McMahon: These proceedings, consolidated for hearing and decision, are for the redetermination of deficiencies in income tax for the year 1929 asserted by the respondent as follows:

Docket No. 60890	$5,831.67
Docket No. 60891	3,570.84
Docket No. 60892	3,771.04
Docket No. 60893	1,158.44

19 It is alleged that the respondent erred in finding that the preferred stock dividend, which the Hamilton Manufacturing Company distributed to petitioners on July 1, 1929, was redeemed by such corporation in such a manner as to make the transaction equivalent to the distribution of a taxable dividend.

Our findings of fact are based upon the pleadings, stipulation entered into between the parties and the testimony of witnesses who testified at the hearing.

The petitioners, H. C. Gowran, George S. Hamilton, and Edward P. Hamilton, are individuals residing at Two Rivers, Wisconsin. The petitioner, Edith Rose Suddard is the duly appointed and qualified executrix of the estate of Thomas W. Suddard, deceased, who died September 11, 1931, having been nominated as such executrix in the will of the decedent. She also resides at Two Rivers, Wisconsin.

The parties entered into the following stipulation:

"(1) Hamilton Manufacturing Company (hereinafter referred to as the company) is a corporation organized under the laws of Wisconsin on February 23, 1926, having its principal office and place of business at the City of Two Rivers, Wisconsin. Article III of its 'Articles of Organization' is as follows:

"'The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

"'Ten thousand (10,000) shares of said stock, with a par value of One Hundred Dollars ($100) per share, aggregating One Million

Dollars ($1,000,000.00), shall be preferred stock and bear a preferential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and fifteen thousand (15,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock.

"'The holders of shares of said common stock without nominal or par value shall be entitled to all the rights and powers with relation to said stock; and with relation to their right to vote in stockholders' meetings and with relation to choosing directors, which are conferred on stockholders by law and by these Articles of Organization and by the By-Laws of the corporation; and wherever by these Articles of Organization rights and privileges are granted to stockholders or restrictions or limitations are placed upon stockholders, it is hereby declared that only the holders of the common stock are mena unless specifically designated otherwise.

"'The common stock without nominal or par value may be issued by the corporation from time to time, for such consideration as may be fixed from time to time by the Board of Directors thereof.

"'Dividends at the rate of seven per cent. (7%) per annum may be paid by the corporation on its outstanding preferred stock, if the net profits of the corporation shall be sufficient therefor, and may be paid, at the option of the directors, semi-annually or quarterly. The common stock shall not receive dividends for any year unless seven per cent. (7%) shall first be paid for that year on the par value of all the preferred stock then outstanding together with all arrears of dividends on preferred stock at the like rate for previous years; but when seven per cent. (7%) shall have been paid for any year upon the par value of such preferred stock, together with all arrears of dividends at the like rate for previous years, the residue of the net profits of the corporation may then be distributed as dividends ratably to the holders of the common stock. Dividends on either preferred or common stock shall in no case be paid out of corporate assets not accruing from profits.

"'Upon the liquidation or dissolution or winding up of said corporation (whether voluntary or involuntary) the preferred stock shall be entitled to receive out of the assets of the corporation in money or in money's worth the face or par value of the preferred stock then issued and outstanding, and no more; but if upon such liquidation, dissolution or winding up, the corporation shall have, after payment of all its debts and obligations, assets which have accrued from profits the preferred stock shall be entitled to receive out of assets which have accrued from profits (but not out of other assets) payment of all of the seven per cent. (7%) annual dividends which may then be in arrears, but no more. Thereafter the residue of the funds and assets of the corporation

shall be divided equally among the shares of common stock then issued and outstanding.

"'The corporation shall have the right to purchase and redeem any part or all of said preferred stock on January first or July first in any year, by paying for each share of such preferred stock the sum of One Hundred Two and 50/100 Dollars ($102.50) together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock, when so redeemed by the corporation, shall be cancelled, but may be again sold and new certificates therefor issued.

"'The holders of preferred stock in said corporation shall have no vote in the meetings of its stockholders nor in choosing directors nor otherwise in the management of the corporation.

"'All certificates evidencing issues of either preferred stock or common stock of the corporation shall bear on the face thereof statement of all privileges accorded to an all restrictions imposed on the preferred stock of the corporation.

"'The corporation may fix a fiscal year by By-Law, which may or may not be identical with the calendar year; and all computations of profits for the purpose of determining whether or not dividends are payable, and to what amount, shall be made upon the profits of each recurring fiscal year if a fiscal year shall be fixed as herein provided, otherwise upon profits of each recurring calendar year.'"

On April 5, 1926, the seventh paragraph of Article III of the "Articles of Organization" was amended to read as follows:

"The corporation shall have the right to purchase and redeem any part or all of said preferred stock on January first or
22 July first in any year, by paying for each share of such preferred stock the sum of One Hundred Five Dollars ($105.00), together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock when so redeemed by the corporation shall be canceled, but may be again sold and new certificates therefor issued."

On December 27, 1928, Article III of the "Articles of Organization" was further amended by striking out the first two paragraphs thereof and inserting in their stead the following two paragraphs:

"The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

"'Ten thousand (10,000) shares of said stock, with a par value of One Hundred Dollars ($100) per share, aggregating One Million Dollars ($1,000,000.00), shall be preferred stock and bear a prefer-

ential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and thirty thousand (30,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock.'"

(2) On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by thirty individuals in amounts ranging from 1 share to 6,189 shares, the petitioners' holdings thereof being as follows:

H. C. Gowran	3,812.25 shares.
Thomas W. Suddard	2,833.8 shares.
George S. Hamilton	6,189 shares.
Edward P. Hamilton	1,619.25 shares.

The four petitioners were holders of common stock of the company throughout the year 1929.

23 (3) On and up to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7155 shares, held by approximately 300 individual stockholders, the petitioners holding no shares of preferred capital stock prior to July 1, 1929.

(4) On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

(5) At a special meeting of the Board of Directors of the Company held on June 29, 1929, the following transpired:

"On this date at eleven o'clock A. M. the Board of Directors of Hamilton Manufacturing Company, convened pursuant to consent of all directors.

"Director E. P. Hamilton duly offered the following resolution and upon motion made and seconded, it was unanimously adopted by the Board:

"Whereas, on the date of this special meeting of the Board of Directors of Hamilton Manufacturing Company, to-wit: June 29, 1929, the surplus of the company is in excess of $261,531.20; and

"Whereas, the company can at the present time lawfully declare and distribute a dividend to the holders of its common capital stock, in the sum of $261,531.20; and

"Whereas, the outstanding common capital stock of the company on this date is 18,680.8 shares, and a dividend of $14.00 per share on all of said common capital stock would amount in all to $261,531.20; and

"Whereas, of the authorized preferred stock of the company, amounting to 10,000 shares at $100.00 per share, or $1,000,000.00 in all, there remain unissued 2,616 shares or more, having a par value of $261,600.00, which unissued shares of preferred stock are available for issue by way of a stock dividend; and

"Whereas, it is for the best interests of the company and its stockholders that a dividend of $14.00 per share be declared and paid at this time on all of the issued and outstanding common

capital stock of the company, the same to be paid, however, in the preferred stock of the company, computed at the par value thereof, viz.: $100.00 per share; now therefore

"Resolved, by the Board of Directors of Hamilton Manufacturing Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz.: $100.00.

"Resolved Further, that in distributing the stock dividend hereby declared, no fractional shares of preferred stock be made use of, and that the treasurer of the company be and he hereby is directed to adjust with each stockholder, by cash payments (from the stockholder to the company, or from the company to the stockholder, as the case may be), any fractional share by which the company has overpaid or underpaid such stockholder."

* * * * * * *

(6) Pursuant to the foregoing resolution, a stock dividend was paid in shares of the company's preferred stock of the par value of $100.00 per share.

(7) Said stock dividend amounted to $14.00 on every share of common stock then outstanding, or $261,531.20 in all (18680.8 x $14.00); and the same was paid to common stockholders by the distribution to them on July 1, 1929 of 2615.312 shares of the company's preferred stock.

(8) H. C. Gowran, the owner of 3812.25 shares of common stock, was entitled to, and did receive 533.715 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(9) Thomas W. Suddard (now represented by Edith Rose Suddard, Executrix), the owner of 2833.8 shares of common stock, was entitled to, and did receive 396.732 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(10) George S. Hamilton, the owner of 6189 shares of common stock, was enttiled to, and did receive 866.46 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(11) Edward P. Hamilton, the owner of 1,619.25 shares of common stock, was entitled to, and did receive 226.695 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(12) Throughout the year 1929, the officers of the company were as follows: George S. Hamilton, President; H. C. Gowran, Vice-president; Thomas W. Suddard, Secretary; and Edward P. Ham-

ilton, Treasurer; and these four individuals, together with J. E. Hamilton, constituted the Board of Directors of the Company.

* * * * * * * *

The Hamilton Manufacturing Company had a policy, since its organization, of selling its preferred stock to its employes. Although it had no policy or agreement with its employes to take back any of such stock the Company from time to time repurchased some of the preferred stock from its employes. As the demand for such preferred stock had amounted to only about two or three hundred shares more than had been returned during the fiscal year ended June 30, 1929, the directors of the Company at the time the preferred stock dividend was determined upon were of the opinion that the unissued preferred stock consisting of 229 shares would be sufficient to supply the employes' demand therefor. In September, 1929, it appeared that there was a demand by employes, their near relatives, and stockholders for a total of some 1,800 shares of preferred stock, which demand would have to be met October 1, 1929. The Company issued its stock quarterly on dividend paying dates.

The manner and method of meeting this demand for preferred stock was discussed informally by the four petitioners and one of them suggested that they sell to the Company the preferred stock which they had received as dividends. Two of the petitioners objected because they did not wish to dispose of their preferred stock holdings but after considerable informal discussion it was finally agreed that the four petitioners, together with another stockholder who owned 28 shares, would sell to the Company at par all the preferred stock received by them as dividends on July 1, 1929. It was considered that the previous small demand for the preferred stock did not justify increasing the authorized capital stock of the Company. By the end of the year 1929 a net amount of 475 shares of preferred stock had been disposed of by the Company. A
26 greater number had been actually sold but shares were returned by employes in various amounts, for example, 56 shares were returned in November 1929, and 5 shares in December 1929. However, the supply of preferred stock was exhausted during the fiscal year ended June 30, 1930. On December 31, 1930, the Company had issued 10,526 shares of preferred stock of the par value of $1,052,600, the Company having in the meantime increased its authorized capital of preferred stock to 20,000 shares.

On June 30, 1929, the Company had cash in banks and on hand in the amount of $177,052. On July 1, 1929, the Company was required to pay a cash dividend of $1.75 per share on its outstanding preferred stock of 7,155 shares and $2.50 per share on its outstanding common stock of 18,680 shares, which amounted to a total of $59,221.25.

No proceedings were taken at any time by the Company under its articles of incorporation for the redemption of its preferred stock. No notice required under the provisions of its articles of incorpora-

tion for the redemption of preferred stock was ever issued by the Company. No redemption premium on preferred stock was ever paid by the Company. The Company at no time, either expressly or impliedly, promised to "do anything other than issue this (preferred stock dividend declared June 29, 1929) as a preferred stock dividend" nor did it promise to convert at any time at the option of any stockholder such stock dividend into cash, nor did it grant to any of its stockholders an election or option to take either stock or cash in payment of such dividend.

It is the position of the respondent that in this proceeding there was a distribution and cancellation or redemption made at such time and in such manner as to make it equivalent to the distribution of a taxable dividend under section 115 (g) of the Revenue Act of 1928.[1]

It is contended by the petitioners that the transaction involved herein was a sale by the petitioners on October 1, 1929, to the Hamilton Manufacturing Company of its preferred stock issued to the petitioners on July 1, 1929, as a stock dividend, to supply the
27 Company with sufficient stock to meet demands made therefor by its employes, their near relatives, and stockholders.

In our opinion, this proceeding is governed by Alfred A. Laun, 26 B. T. A. 764, cited and relied on by petitioners; and upon the authority of our decision in that proceeding we hold in favor of the petitioners. See that case for authorities cited therein and discussion.

In Henry B. Babson, 27 B. T. A.—No. 55, the Board in its opinion states as follows:

"These cases (Alfred A. Laun, supra, Pearl B. Brown, Executrix, 26 B. T. A. 901; Harry A. Koch, 26 B. T. A. 1025; Robert R. Meyer, 27 B. T. A. 44; Annie Watts Hill, 27 B. T. A. 73) lay as one test for determining whether a distribution in cancellation or redemption of stock falls within the provisions of the statute, the existence of a relation between the issuance and redemption of the stock which evidences a continuing plan to effect by this means a distribution of corporate earnings, freed from the usual incident of tax upon ordinary dividend distribution. * * *

"But, as another test of the applicability of the statute to transactions such as these before us, we must scrutinize the redemption and distribution with respect to the time and manner when they occur, and the circumstances surrounding them at that time." Annie Watts Hill, supra.

In the instant proceeding the Company by resolution declared a preferred stock dividend, which was issued July 1, 1929. Redemption of the outstanding preferred stock, or any of it, was not

[1] Sec. 115. (g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. * * *

authorized by the Company at that time, and the preferred stock issued to the petitioners July 1, 1929, as a stock dividend, was not redeemed by the Company as provided in its articles of incorporation. However, it appears that the petitioners, at some time subsequent to September 1929, agreed to sell at par to the Company all of the preferred stock issued to them as dividend on July 1. The Company purchased such preferred stock from the petitioners at par on or about October 1, 1929, and sold all of it, together with its unissued preferred stock, to others before June 30, 1930. Thereafter, because of the continued demand for its preferred stock, the Company increased its authorized capital preferred stock so as to supply the demand. The petitioner, H. C. Gowran, vice-president and director of the Company, testified that before deciding to turn in the stock to the Company the petitioners considered the questions

28 (1) whether to close the issuance of any more preferred stock, (2) whether to increase the authorized preferred stock or (3) whether to redeem the preferred stock or some of it at the call price of $105; but that the petitioners finally determined to sell the stock to the Company, and he stated that—

"There was no reason for us selling it back to the company absolutely. We could have sold it to the individuals personally, and there never would have been a question raised. * * * It was put back in the Company for the convenience of the employes."

Furthermore, there was no cancellation of the preferred stock within the meaning of section 115 (g). It is true that the certificates representing the preferred stock issued to the petitioners on July 1 were returned to the Company and cancelled, but other certificates were issued in their stead to those having made demand for the Company's preferred stock prior to October 1, or to those who thereafter purchased preferred stock of the Company. The Company's stock liability remained approximately the same except during the short interim between the purchase of the preferred stock from the petitioners and the sale of the same to others as heretofore pointed out. In fact the stock liability of the Company subsequently increased as its total authorized preferred stock was issued and outstanding June 30, 1930.

The Company was in a position to pay petitioners for their preferred stock sold to it out of funds received from the later sales of the same stock and it was not necessary for the Company to distribute profits to acquire the same.

In our opinion, the Company did not cancel or redeem in the year 1929 preferred stock issued by it as a stock dividend to the petitioners at such time and in such manner as to make the distribution and cancellation in whole or in part essentially equivalent to the distribution of a taxable meaning of section 115 (g). See T. Pierre Champion, 27 B. T. A.—No. 139 and Louis Rorimer, 27 B. T. A.—No. 56.

Decision will be entered under Rule 50.

Enter June 29, 1933.

29 Before United States Board of Tax Appeals

(Caption—60890–3)

Motion for reconsideration, etc.

Filed July 16, 1933

The respondent by his attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, moves (1) for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-styled proceedings, (2) for review by the Board as provided by Section 906 (d) of the Revenue Act of 1924, as amended by Section 1000 of the Revenue Act of 1926, and (3) for judgment for the respondent.

GROUNDS OF MOTION

The "Memorandum Opinion" is in conflict with the case of Tillotson Manufacturing Company v. Commissioner, decided by the Board on March 11, 1933 (27 B. T. A.———).

ARGUMENT IN SUPPORT OF MOTION

In deciding the Tillotson Manufacturing Company case, the Board laid down the principles that not every dividend in stock is a stock dividend, and that only those which place the shareholders in no essentially different position are exempt. The Board there held that the dividend on preferred stock of Willys-Overland Company paid in its own common stock to Tillotson Manufacturing Company was not a stock dividend.

The facts briefly are as follows:

Article III of the "Articles of Organization" of Hamilton Manufacturing Company, a Wisconsin corporation organized February 23, 1926, as amended on April 5, 1926, and again on December 26, 1928, discloses that the company had a capital structure of 10,000 shares of preferred stock of the par value of $100.00 each and 30,000 shares of common stock without nominal or par value; that the holders of the common stock are entitled to all the rights and powers with relation to said stock and with relation to their right to vote in stockholders' meetings and to choose directors; that the holders of the preferred stock are entitled to cumulative dividends of 7% and to receive, upon liquidation or dissolution or winding up of the
30 company, the face or par value of the preferred stock then issued and outstanding, but the holders of the preferred stock have no vote in the meetings of the stockholders nor in choosing directors nor otherwise in the management of the company.

On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by thirty individuals

in amounts ranging from 1 share to 6189 shares, the petitioners' holding thereof being as follows:

H. C. Gowran	3,812.25 shares.
Thomas W. Suddard	2,833.8 shares.
George S. Hamilton	6,189 shares.
Edward P. Hamilton	1,619.25 shares.

The four petitioners were holders of common stock of the company throughout the year 1929.

On and up to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7,155 shares, held by approximately 300 individual stockholders, the petitioners holding no shares of preferred capital stock prior to July 1, 1929.

On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

At a special meeting of the Board of Directors of the company held on June 29, 1929, the following resolution was passed:

"Resolved, by the Board of Directors of Hamilton Manufacturing Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz: $100.00."

H. C. Gowran, the owner of 3812.25 shares of common stock, was entitled to, and did receive 533.715 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

Thomas W. Suddard (now represented by Edith Rose Suddard, Executrix), the owner of 2833.8 shares of common stock, was
31 entitled to, and did receive 396.732 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

George S. Hamilton, the owner of 6189 shares of common stock, was entitled to, and did receive 866.46 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

Edward P. Hamilton, the owner of 1619.25 shares of common stock, was entitled to, and did receive 226.695 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

Throughout the year 1929, the officers of the company were as follows: George S. Hamilton, President; H. C. Gowran, Vice President; Thomas W. Suddard, Secretary; and Edward P. Hamilton, Treasurer; and these four individuals, together with J. E. Hamilton, constituted the Board of Directors of the company.

In the Tillotson Manufacturing Company case, the Board says:

"Analyzing the facts in this proceeding in the manner prescribed in Eisner v. Macomber, supra, the want of essential similarity is immediately apparent. This was not a proportional redistribution of existing or inchoate rights. There was a substantial change in the shareholder interests not only of this petitioner but of all other shareholders as well. Whether the adventitious effect of this at any given time to any one shareholder be for better or worse may serve to measure the gain or loss, but it leaves the change no less substantial. This petitioner as a preferred shareholder not only enjoyed the benefits of its preference and the assurance which the provision for cumulative dividends might give, but it also was subject to the limitations of a fixed dividend and a contingent right to vote. By this dividend, it acquired new and separate rights of a common shareholder to participate in unlimited dividends and liquidations and unqualifiedly in the shareholders' meetings."

The only essential difference between the two cases is that Tillotson Manufacturing Company received common stock as a dividend on preferred stock, while the petitioners here received preferred stock as a dividend on common stock. This difference is of no consequence. The same principle applies. The privileges enjoyed by petitioners as common stockholders were different from their privileges as preferred stockholders in the same respects as set forth in the Tillotson Manufacturing Company case; and further, only as common stockholders did petitioners have the right to vote in the meetings of stockholders, to choose directors and to have a voice in the management of the company.

32

A stipulation filed with the Board refers to the dividend as a "stock dividend", and it was on this theory that the deficiencies were determined and the cases presented to the Board. However, the Board is not bound by a conclusion of law. (John A. Nelson Co. v. Commissioner, decided by the Board on June 23, 1933.) A resolution dealing with the dividend is a part of the stipulation.

"Whether there has been a tax-free stock dividend is to be determined not by the terms used but by an analysis of the legal effect of what was done in the name of a stock dividend." Tillotson Manufacturing Co. v. Commissioner, supra.)

But one more point remains—the fair market value of the preferred stock on July 1, 1929, the date of distribution. The deficiency notice treats this stock as taxable at $100.00 per share. Consequently, if the stock had a fair market value of $100.00 per share, the deficiency determined by the Commissioner is correct and should be sustained.

With respect to this latter point, Article III of the "Articles of Organization", as amended, provides for redemption of the preferred stock at $105.00 per share on January 1 or July 1 in any year. On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05. The company had a policy of selling preferred stock to its employees. In the year prior to July

1, 1929, some two or three hundred shares were purchased by the employees. A demand for the stock arose immediately after July 1, 1929. It sold for $100.00 per share without solicitation. Everybody had money, and most of the employees paid all cash for preferred stock. By the end of September 1929, the demand for this stock had risen to about 1800 shares. The founder of the company and chairman of the Board of Directors, J. E. Hamilton, purchased
1500 shares at $100.00 per share, paying all cash. It is sub-
33 mitted that the facts amply support a finding that the preferred stock on July 1, 1929 had a fair market value of $100.00 per share.

Wherefore, it is prayed that this motion be granted.

E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
J. E. MARSHALL,
Special Attorney, Bureau of Internal Revenue.

Before United States Board of Tax Appeals

(Caption—60890-3)

Order denying motion for review

Entered July 24, 1933

The Board having entered its memorandum opinion in the above-entitled proceedings on June 29, 1933, the respondent filed a motion on July 18, 1933, requesting review by the Board of the said memorandum opinion, and upon consideration of said motion and the grounds set forth in support thereof, it is

Ordered, That the said motion be and the same is hereby denied.

(Signed) LOGAN MORRIS, *Chairman.*

Dated, Washington, D. C., July 24, 1933.

Before United States Board of Tax Appeals

(Caption—60890-3)

Order denying motion for reconsideration, etc.

Entered Jan. 15, 1934

Counsel for the respondent having on July 18, 1933, filed a motion (1) for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-entitled proceedings, (2) for review by the Board as provided by Section 906 (d) of the Revenue Act of 1924, as amended by Section 1009 of the Revenue Act of 1926, and (3) for

judgment for the respondent; on the ground that such "Memorandum
Opinion" is in conflict with the case of Tillotson Manufactur-
34 ing Co., 27 B. T. A. 913, and the motion (2) for review by the
Board having been denied by order dated July 24, 1933; and a hearing on the motions (1) for reconsideration and (3) for judgment for the respondent having been had on August 28, 1933; and the motions and reasons therefor submitted by respondent with his said motions and argument of counsel at the hearing and on briefs having been duly considered, now, therefore, it is

Ordered that the motions of respondent for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-entitled proceedings and for judgment for the respondent be and the same hereby are denied. (See Memorandum attached.)

(Signed) STEPHEN J. MCMAHON, *Member.*

Dated: Washington, D. C., January 15, 1934.

Before United States Board of Tax Appeals

(Caption—60890-3)

Memorandum on motion for review, etc.

In his motion filed July 18, 1933, the respondent moved, among other things, for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-entitled proceedings for judgment for the respondent on the ground that the "Memorandum Opinion" entered in these proceedings is in conflict with the case of Tillotson Manufacturing Co., 27 B. T. A. 913, which held that a dividend declared upon cumulative nonvoting preferred shares payable in common voting shares is, as to the preferred shareholder, not a tax-free stock dividend, for the reason that there "was not a proportional redistribution of existing or inchoate rights. There was a substantial change in the shareholder interests not only of this petitioner but of all other shareholders as well."

In the instant proceedings a dividend was declared upon common stock payable in preferred stock. At the time of the declaration of the dividend payable in preferred stock, the interest of the common stockholders in the corporation was represented by the amount of the capital stock outstanding plus the amount of the surplus. Part of this surplus was set aside as dividends payable in preferred stock. Thus, as stated in Eisner v. Macomber, 253 U. S. 189,

This, however, is no more than a book adjustment, in essence
35 not a dividend but rather the opposite; no part of the assets of the company is separated from the common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company, but profits so far absorbed in the business as to render it impracticable to separate them for with-

drawal and distribution. In order to make the adjustment, a charge is made against surplus account with corresponding credit to capital stock account, equal to the proposed "dividend"; the new stock is issued against this and the certificates delivered to the existing stockholders in proportion to their previous holdings. This, however, is merely bookkeeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; it affects only the form, not the essence, of the "liability" acknowledged by the corporation to its own shareholders, and this through a readjustment of accounts on one side of the balance sheet only, increasing "capital stock" at the expense of "surplus"; it does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. * * *

* * * * * * *

We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction.

To similar effect is Frances Elliot Clark, 28 B. T. A. 1227.

Furthermore, in Tillotson Manufacturing Co., supra, the Board held that the petitioner in that case as a preferred stockholder

"not only enjoyed the benefits of its preference and the assurance which the provision for cumulative dividends might give, but it also was subject to the limitations of a fixed dividend and a contingent right to vote. By this dividend, [common stock to preferred stockholders] it acquired new and separate rights of a common shareholder to participate in unlimited dividends and liquidations and unqualifiedly in the shareholders' meetings."

Such is not the case in these proceedings. As common
36 stockholders the petitioners in these proceedings had and enjoyed all the rights, prior to the issuance of the stock dividend, which the petitioner in Tillotson Manufacturing Co., supra, as a preferred stockholder did not have, but which it acquired with the receipt of the common stock as a dividend. The petitioner in these proceedings, as common stockholders, prior to the issuance of the preferred stock dividend, had and enjoyed the "separate rights of a common shareholder to participate in unlimited dividends and liquidations and unqualifiedly in the shareholders' meeting." On the other hand, as stated before, a portion of that which represented the book value of the common stock held by the petitioners in these proceedings, or a portion of their interest in the corporation, was set aside from surplus to capital. In other words, they received in preferred stock a portion of their then interest in the corporation.

The motion of the respondent should therefore be denied.

STEPHEN J. MCMAHON, *Member.*

Before United States Board of Tax Appeals

(Caption—60890–3)

Order vacating order of Jan. 15, 1934, etc.

Nov. 20, 1934

In these proceedings a Division of the Board entered its Memorandum Opinion on June 29, 1933, and on July 18, 1933, the respondent filed a motion for (1) Board review of the Opinion, (2) reconsideration and (3) judgment for the respondent. The motion states that the opinion is in conflict with Tillotson Manufacturing Co., 27 B. T. A. 913. The motion was denied as to its request for Board review and set for hearing as to its two other requests. Subsequent to the hearing, Division No. 16 of the Board entered an order, dated January 15, 1934, denying the motion for reconsideration and judgment. On January 26, 1934, respondent moved for Board review of such order. On January 31, 1934, the Board reviewed that order and accompanying memorandum of Division No. 16, dated January 15, 1934. Upon that review, and the record as then constituted, such order was disapproved by the Board and accordingly, by direction of the Board, it is

37 Ordered, that the aforementioned order dated January 15, 1934, be and the same is hereby vacated, and it is

Further Ordered that respondent's motion for reconsideration of the Memorandum Opinion entered June 29, 1933, be and the same is hereby granted.

[SEAL] (Signed) J. RUSSELL LEECH, *Member.*

Dated: Washington, D. C. November 20, 1934.

McMahon dissents upon the record, disclosing, among other things, a tax free stock dividend the value of which is immaterial here.

Before United States Board of Tax Appeals

(Caption—60890–3)

Motion to vacate order of Nov. 20, 1934, etc.

Filed at Hearing Feb. 13, 1935

The petitioners above named, by their attorney, A. L. Nash, move (1) that the order made in these proceedings by J. Russell Leech, Member of the Board, under date of November 20, 1934, whereby respondent's motion for reconsideration of the memorandum opinion entered June 29, 1933, was granted, be vacated and set aside; (2) that respondent's said motion for reconsideration of the memorandum opinion be denied; and (3) that judgment be ordered for the petitioners in accordance with the prayer of their petitions.

GROUNDS OF MOTIONS

I

1. On June 29, 1933, Division 16 of the Board made a memorandum decision, finding in favor of petitioners on the issue raised by the petitions and the answers of the respondent.

2. On July 24, 1933, review of the decision of Division 16 was denied by the Board.

3. No review of the decision of Division 16 of the Board was ordered by the Chairman of the Board, or otherwise, within thirty days after the date of said memorandum decision.

4. The memorandum decision became the decision of the Board thirty days after June 29, 1933, or on July 29, 1933.

38 5. No petition for review by the United States Circuit Court of Appeals was filed within three months after the memorandum decision above mentioned became the decision of the Board.

6. The respondent's motion for reconsideration of the memorandum decision of Division 16 of the Board was argued in Chicago on August 28, 1933, and was denied by an order of Division 16 dated January 15, 1934; and if it should be the law that this pending motion for reconsideration stopped the running of the time for the filing of a petition for review, then it appears that the time for filing a petition for review began to run on January 15, 1934, and expired on April 15, 1934.

7. Respondent's motion, made January 26, 1934, was merely for review by the Board of the order denying reconsideration made on January 15, 1934, and said last mentioned motion did not stop the running of the statutory time limit, so that the decision of the Board, dating from July 29, 1933, became final in any event on April 15, 1934.

For these reasons the first motion set forth above should be granted, viz.: that the order signed by J. Russell Leech, Member of the Board, dated November 20, 1934, granting respondent's motion for reconsideration, should be vacated because made and entered long after the Board's decision in the proceedings had become final.

II

1. For the same reasons set forth above, it is urged that respondent's motion for reconsideration of said memorandum opinion should be denied by an order at this time.

III

1. For the same reasons set forth above, and because the decision of the Board, of date July 29, 1933, became final not later than April

15, 1934, petitioners' motion for judgment in their favor should be granted.

Dated February 13, 1935.

A. L. Nash,
A. L. Nash,
Attorney for Petitioners,
Manitowoc Savings Bank Bldg., Manitowoc, Wisconsin.

Denied June 27, 1935. (s) J. Russell Leech, Member U. S. Board of Tax Appeals.

39 Before United States Board of Tax Appeals

(Caption—60890–3)

Stipulation re certain fact

Filed Feb. 13, 1935

(Read into the Record February 13, 1935)

Mr. Nash: * * * Now, counsel may dictate the stipulation. and then I will dictate my condition.

Mr. Thomas: It is hereby stipulated and agreed, by and between the parties hereto, by their respective counsel, that for the purpose of these proceedings the following fact may be taken as true;

That the fair market value of the preferred stock of the Hamilton Manufacturing Company as of July 1, 1929, was $100 per share.

Mr. Nash: Now for the petitioners, your Honor, the stipulation just dictated into the record by counsel for respondent is admitted as true, with this reservation, that the fact stipulated is immaterial and irrelevant, for the reason that the dividend disclosed by the record was a tax-free stock dividend, so that the value of the shares of preferred stock distributed in such stock dividend has no bearing on the case; and the admission of petitioners of the stipulated facts, is made without prejudice to their rights to maintain, in argument or otherwise, their claim that such stock dividend was tax-free.

Before United States Board of Tax Appeals

(Caption—60890–3)

Promulgated June 27, 1935

Dividends.—Where both common and preferred shares are outstanding when a dividend is declared upon voting common stock and paid in nonvoting cumulative preferred shares at par value, such dividend is not a tax-free stock dividend. Tillotson Manufacturing Co. v. Commissioner, 76 Fed. (2d) 189, affirming 27 B. T. A. 913; James H. Torrens, 31 B. T. A. 787, followed.

A. L. Nash, Esq., for the petitioners.

Isadore Graff, Esq., for the respondent.

Opinion

Filed June 27, 1935

LEECH: These consolidated proceedings are under reconsideration pursuant to the Board's order dated November 20, 1934. By order dated November 24, 1934, the proceedings were set for hearing evidence limited to the fair market value on July 1, 1929, of the Hamiltion Manufacturing Co. preferred stock. At such rehearing on February 13, 1935, petitioners filed a motion that the Board vacate its order directing reconsideration, that the Board deny respondent's motion for reconsideration of the memorandum opinion heretofore entered, and that the Board enter judgment for petitioners. The principal ground for such motion is that the memorandum opinion had become final and that the Board was without authority, on November 20, 1934, to direct a reconsideration. In these proceedings the Board has never entered its final order, pursuant to section 601 (d) of the Revenue Act of 1928. Thus, the Board, not having entered its decision in these proceedings, has the power to reopen the cases and revise its prior findings of fact and opinion. Washburn Wire Co. v. Commisioner, 67 Fed. (2d) 658. Accordingly, petitioners' motion filed on February 13, 1935, is denied.

The respondent has determined income tax deficiencies for the year 1929 in the following amounts:

Docket No. 60890	$5,831.67
Docket No. 60891	3,570.84
Docket No. 60892	3,771.04
Docket No. 60893	1,158.44

He determined that preferred shares issued as a dividend on the common shares of the Hamilton Manufacturing Co., on July 1, 1929, were redeemed by the company in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend under section 115 (g) of the Revenue Act of 1928.

The petitioners assigned error in such determination.

The Board, in its memorandum opinion heretofore entered, considered the proceedings only upon the basis of such assigned error and determined, upon the facts, that the preferred stock was not redeemed in 1929 in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend. The parties did not specifically raise, nor did the Board consider, the question of whether the dividend was tax-free or taxable to
41 petitioners when the shares were issued on July 1, 1929. The latter question has now been specifically raised by the granting of the respondent's motion for reconsideration on the ground that the memorandum opinion, heretofore entered, is in conflict with the decision in Tillotson Manufacturing Co. v. Commissioner, 76 Fed. (2d) 189, affirming 27 B. T. A. 913.

In deciding now whether the present dividend was tax-free or taxable, we are not considering a new issue raised for the first time

by respondent's motion. The deficiency in controversy is asserted upon the basis of the respondent's determination that the dividend was taxable. The correctness of that deficiency is the general issue, in the consideration of which the Board is not limited to the theory advocated by either the respondent or the taxpayer. Charles L. Coughlin, 15 B. T. A. 515, 519; James P. Gossett, 22 B. T. A. 1279; affd., 59 Fed. (2d) 365; John I. Chipley, 25 B. T. A. 1103. The question before the Board now, as originally, inherently involves the taxable character of the dividend revealed by the evidence of record. If it be determined that the dividend was not a tax-free stock dividend when made on July 1, 1929, and therefore properly includable in income, that conclusion would be decisive here without passing upon the question of whether there was a redemption within the meaning of section 115 (g) of the 1928 Act.

There follow only those facts necessary to a determination of the one question now under consideration.

The petitioners, H. C. Gowran, George S. Hamilton, and Edward P. Hamilton, are individuals residing at Two Rivers, Wisconsin. The petitioner, Edith Rose Suddard, is the duly qualified executrix of the estate of Thomas W. Suddard, deceased, who died testate September 11, 1931. She also resides at Two Rivers, Wisconsin.

Hamilton Manufacturing Co., hereinafter referred to as the company, was incorporated on February 23, 1926, under the laws of Wisconsin. Article III of its "Articles of Organization" as amended on April 5, 1926, and on December 27, 1928, provides that the company's capital stock shall be divided into 10,000 shares of preferred stock of the par value of $100 each, entitled to a preferential cumulative dividends at the rate of 7 percent per annum, payable out of net profits; and 30,000 shares of common stock without nominal or par value. Article III further provides that the holders of common stock shall have certain rights and powers, including voting rights,

> and, that the company shall have the right to purchase and
> 42 redeem any part or all of the preferred stock on the first of
> January or July in any year, by paying $105 for each share

together with accrued dividends, and that the preferred stock when so redeemed and canceled, may be reissued.

On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by 30 individuals in amounts ranging from 1 share to 6,189 shares.

Prior to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7,155 shares held by approximately 300 individual stockholders. The petitioners held no shares of the company's preferred capital stock prior to July 1, 1929.

On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

The company's board of directors, at a special meeting on June 29, 1929, adopted a resolution which, after setting forth that the company's surplus was in excess of $261,531.20, the total of a $14 per

share dividend on 18,680.8 common shares outstanding, and that there remained unissued $261,600 par value preferred stock available for issue by way of stock dividend, provided in part as follows:

"Resolved, by the Board of Directors of Hamilton Mfg. Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz: $100."

The petitioners' holdings of common shares on July 1, 1929, and the number of preferred shares each was entitled to and did receive pursuant to the above mentioned resolution, were as follows:

	Common shares	*Preferred shares*
H. C. Gowran	3,812.25	533.715
Thomas W. Suddard	2,833.80	396.732
George S. Hamilton	6,189.00	866.46
Edward P. Hamilton	1,619.25	226.695

43 The preferred stock so received by petitioners on July 1, 1929, had a fair market value of $100 per share on that date. Subsequent to September 1929 petitioners agreed to sell to the company at par, all the preferred stock issued to them as a dividend, and on or about October 1, 1929, the company purchased at par all such preferred stock, for resale to its employees.

Petitioners argue that the present dividend on common stock declared and paid in preferred stock of the declarant company, is a stock dividend within the meaning of section 115 (f) of the Revenue Act of 1928,[1] and is, therefore, not taxable.

The authorities upon which they rely are: Alfred A. Laun, 26 B. T. A. 764; Pearl B. Brown, Executrix, 26 B. T. A. 901; affd., 69 Fed. (2d) 602; certiorari denied, 293 U. S. 570; and Frances Elliott Clark, 28 B. T. A. 1225; affd., — Fed. (2d) — (C. C. A., 3d Cir., March 26, 1935).

In all those cases, no preferred stock was outstanding when the preferred in question was distributed as a dividend on or in partial exchange for common stock. Thus, since (1) there was no severance of assets from the declarant corporations, and (2) there was no alteration of the preexisting proportionate interest of the stockholders, but "only a proliferation of preexisting interests" (Pearl B. Brown, Executrix, supra) the disputed dividend was held non-taxable. (Tillotson Manufacturing Co. v. Commissioner, supra.)

In that case, which petitioners attempt to distinguish from the pending situation, there was a substantial amount of common stock outstanding when the dividend on the preferred stock, payable in

[1] Sec. 115 (f). Stock dividends.—A stock dividend shall not be subject to tax.

common, was declared and paid. That fact sustains the Board's conclusion that the second prerequisite above, to the exemption of that dividend from tax, was not there established. The position of the stockholder in receiving such common stock in that distribution was materially changed. He acquired substantially different and, as the court there held, "additional property rights which might well afford him a different and greater market with an increased money return."

So, here as in the Tillotson case, though the first of the two recognized tests (supra) for distinguishing a taxable from a non-taxable dividend, may have been met, the second has not. The pre-
44 existing proportionate interest of the stockholders was substantially changed. It is true that the present record discloses the converse situation as to the class of stock in which the dividend was declared and paid, but in the recent case of James H. Torrens, 31 B. T. A. 787, in applying the rule announced in the Tillotson case to similar facts, this Board said:

"If there be any difference in the degree of change effected in the stockholders' existing rights by the converse factual situation here, we do not think it sufficient to except this case from the application of that rule."

Our immediately pertinent inquiry is the taxable status of this new preferred stock, not from the standpoint of the corporation, but from that of the common stockholders. What did the petitioners, as common stockholders, receive? Here, not only was there a substantial amount of preferred stock of the declarant company outstanding when the present dividend on common was declared and paid in preferred stock, but none of that preferred was then owned by petitioners. The rights and attributes of these preferred and common stocks were materially different. Despite the mechanics of the corporate bookkeeping, which certainly do not control the taxable character of the disputed dividend in the hands of the petitioners (Doyle v. Mitchell Bros., 247 U. S. 179), they, as common stockholders, by the receipt of the present preferred stock, as a dividend, received rights in the assets of the corporation, as to future dividends, and upon liquidation, which were, before receipt of that preferred stock, limited to the then outstanding preferred stock. By the distribution of the preferred stock here, the then existing rights of petitioners, common stockholders, were increased, and those of the then preferred stockholders were decreased, to that extent. Nor is the effect of that fact in evaluating the difference between petitioner's rights before and after the receipt of the questioned preferred stock, avoided here by the financial condition of the corporation at the time of that receipt. Petitioner's rights, though constant in extent during each of those respective periods, were subject to fluctuation in value with that financial condition during each of such periods. It is that continuing potentiality of the common stockholders' new and proportionately altered interests, inherent in the preferred stock in dispute, not the mere liquidating value of that

stock at any particular time, which gave petitioners "additional property rights which might well afford them a different and greater market with an increased money return." Tillotson Manufacturing Co. v. Commissioner, supra.

45 The disputed dividend, on common stock, declared and paid in preferred stock of the declarant company, of a fair market value of $100 per share, when issued on July 1, 1929, was not a tax-free stock dividend.

The memorandum opinion heretofore entered in these proceedings is modified accordingly.

Reviewed by the Board.

Decision will be entered pursuant to Rule 50.

BLACK dissents.

Before United States Board of Tax Appeals

Dissenting opinion

MCMAHON, dissenting: The result reached by the majority in these proceedings is contrary to applicable and corresponding provisions of the revenue acts,[2] rulings and regulations of the Secretary of the Treasury promulgated thereunder,[3] rulings of the Bureau of Internal Revenue,[4] provisions of the Federal Constitution,[5] decisions of the courts,[6] and this Board,[7] and long continued, persistent, uniform practice of the officers charged with the administration of such revenue acts, all of which are controlling here.[8]

The conclusion is unavoidable that Congress has clearly expressed its intention to *exempt all stock dividends from income tax.* Beginning with the 1921 Act, Congress, in section 201 (d), provided that a "*stock dividend* shall not be subject to tax." The term "stock dividend" is a broad term. The language used is plain, simple, and direct. It is here used in its ordinary sense and must be so applied. Congress did not limit or restrict it to any particular type of

46 stock or stock of any particular class or to stock where stock of the same class *is not outstanding.* Obviously, if Congress had intended such limitation it would have so provided.

Congress in section 115 (a) of the applicable 1928 Act defined a taxable dividend as "any *distribution* made by a corporation to its

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[2] Sec. 115 (a), (f), (g), 1928 Act; sec. 201 (a), (f), (g), 1926 Act; sec. 201 (a), (f), 1924 Act; and sec. 201 (a), (d), 1921 Act.

[3] Arts. 628 and 600, Regulations 74; arts. 1548 and 1599, Regulations 69; arts. 1548 and 1599, Regulations 65; art. 1548, Regulations 62; T. D. 3052 and T. D. 3059, 3 C. B. 38 (July–Dec. 1920).

[4] I. T. 2538, IX–1 C. B. 144 (1930); G. C. M. 6709, VIII–2 C. B. 132 (1929); and O. D. 801, 4 C. B. 24 (Jan.–June 1921).

[5] The Sixteenth Amendment and Art. I, sec. 2, cl. 3; Art. I, sec. 9, cl. 4.

[6] Eisner v. Macomber, 252 U. S. 189; Gibbons v. Mahon, 136 U. S. 156; Towne v. Eisner, 245 U. S. 418; United States v. Phellis, 257 U. S. 156; and Weiss v. Stearn, 265 U. S. 242.

[7] Alfred A. Laun, 26 B. T. A. 764; Pearl B. Brown, Executrix, 26 B. T. A. 901; affd., Commissioner v. Brown, 69 Fed. (2d) 602; certiorari denied, 293 U. S. 570; Robert R. Meyer, 27 B. T. A. 44; Louis Rorimer, 27 B. T. A. 871; T. Pierre Champion, 27 B. T. A. 1312; Shelby H. Curlee, Trustee, 28 B. T. A. 773; and Frances Elliott Clark, 28 B. T. A. 1225.

[8] For a fuller discussion of the foregoing citations, with the exception of the Phellis and Weiss cases, see the dissenting opinion in James H. Torrens, 31 B. T. A. 787, 803. 32 B. T. A.

shareholders *whether in money or in other property, out of its earnings of profits* accumulated after February 28, 1913." This definition contains two classes of dividends, i. e., (1) dividends "in money" and (2) dividends "in other property", but both must be "*distributions* * * * *out of its earnings or profits* accumulated after February 28, 1913." (Emphasis supplied.) This section does not include any other classification of dividends, as did the 1916 and 1918 Acts,* the latter including a third classification of dividends "in stock of the corporation." The provision taxing dividends "in stock of the corporation" is the one that was declared unconstitutional in Eisner v. Macomber, supra; and it was therefore omitted in the 1921 Act and subsequent corresponding acts.

In section 115 (f) and (g), of the 1928 Act, and corresponding sections of previous acts back as far as the 1921 Act, Congress dealt only with two kinds of stock dividends, i. e., (1) a "true stock dividend made lawfully and in good faith", Eisner v. Macomber, supra, and (2) a stock dividend not made lawfully or in good faith, or one made to circumvent taxation. However, Congress did not even provide that a *stock dividend* not made lawfully and in good faith should be subject to tax. It provided that if after the issuance of a stock dividend the corporation proceeds to cancel or redeem its stock at such time and in such manner as to make the issuance of such stock and the cancellation or redemption thereof essentially equivalent to the payment of a taxable dividend *the amount received in redemption or cancellation of the stock* shall be treated as a taxable dividend to the extent of the earnings or profits accumulated after February 28, 1913. It is the *amount* subsequently paid by the corporation in cancellation or redemption of such stock dividend not made in good faith that is taxable to the stockholder when received. Hence, when Congress provided that a "stock dividend shall not be subject to tax", it meant every stock dividend of whatever type or class.

Since it was held in Eisner v. Macomber, supra, that Con-
47 gress had no power under the Constitution to tax a dividend in common stock issued to holders of common stock, it was not necessary for Congress to legislate to exempt such common stock dividend from tax. Such legislation would have been futile. Congress had a reason for enacting the provision that a "stock dividend shall not be subject to tax." Cf. National Bank of the Republic of Chicago, 31 B. T. A. 680. This provision accomplishes the purpose of removing any question about the taxability of stock dividends other than common stock on common stock. This is not contrary to Eisner v. Macomber, supra. It is in keeping with it.

As disclosed by T. D. 3059, supra, and subsequent regulations, officers charged with the administration of the revenue acts have repeatedly ruled that *a stock dividend "in whole or in part of a character and preference materially different from the stock upon*

* Sec. 2 (a), 1916 Act; sec. 201 (a) (c), 1918 Act. 32 B. T. A.

which the stock dividend is paid" [emphasis supplied] is *not taxable* income to the stockholder receiving the same.

The substantial reenactment in later acts of provisions theretofore construed by administrative officers is persuasive evidence of legislative approval of the administrative interpretation.[10]

If it were the intention of Congress that the provision of the Revenue Act of 1921 and subsequent acts that a "stock dividend shall not be subject to tax" should apply only to stock dividends issued in common shares upon common shares and the meaning of the term "stock dividend" should be so limited, then such provision, viewed from the standpoint of the facts of the instant proceedings, would be unconstitutional because contrary to Article I, section 2, clause 3, and Article I, section 9, clause 4, of the Federal Constitution, requiring that direct taxes shall be apportioned according to population, and also because contrary to the Sixteenth Amendment, since the stock dividend issued in preferred stock to holders of common stock out of surplus, when other preferred stock is outstanding, represents a portion of the *capital* interest of the holders of common stock or a portion of the "enrichment through increase in value of *capital* investment", which "is not *income* in any proper meaning of the term" as hereinafter more fully pointed out. [Emphasis supplied.] Eisner v. Macomber, supra. To the same effect
48 are Towne v. Eisner, supra, and Gibbons v. Mahon, supra.

It is elementary that if it can be done legislation must be construed so as to bring it within the Constitution rather than in conflict with the Constitution. The construction put upon the applicable section of the act by the majority is contrary to the applicable provisions of the Constitution.

If we assume for the purpose of discussion that Congress has power under the Constitution to tax a stock dividend such as we have here there is nothing in the Constitution to make it mandatory upon Congress to do so; Congress has not done so; on the contrary, Congress has expressly exempted such dividend from income tax.

In truth and logic, looking to substance and not to form, and disregarding mere bookkeeping entries, or lack of them or their mechanics, as is done in this dissent, all of the reasoning of the Supreme Court in Eisner v. Macomber, supra, in holding that a common stock dividend on common stock is not income or otherwise taxable, applies with equal force to the preferred stock dividend on common stock with other preferred stock outstanding, in question in these proceedings, and requires a similar result, and is in part set forth in the margin.[11]

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[10] Zellerbach Paper Co. v. Helvering, 293 U. S. 172; Helvering v. Bliss, 293 U. S. 144; Brewster v. Gage, 280 U. S. 227; National Lead Co. v. United States, 252 U. S. 140. 32 B. T. A.

[11] * * * This ["declaring a 'stock dividend'"], however, is no more than a book adjustment, in essence not a dividend but rather the opposite; no part of the assets of the company is separated from the common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company, but profits so far absorbed in the business as to render it impracticable to separate them from withdrawal and distribution. In order to make the adjustment, a charge is made against surplus

The Hamilton Manufacturing Co. on June 29, 1929, declared a stock dividend on common stock to the extent of $14 per share
49 payable in its unissued preferred stock of the par value of $100 per share; and it paid the same by issuing such stock on July 1, 1929. This required no distribution of corporate money or other property, but only bookkeeping entries showing the transfer of $261,531.20 (18,680.8×$14) from surplus to preferred stock liability, both on the liability side of the balance sheet, so that the preferred stock liability woud be $977,031.20 with 9,770.312 shares outstanding instead of $715,500 with 7,155 shares outstanding, and the surplus of $444,147.05, after deducting also the July 1, 1929, quarterly preferred stock cash dividend and common stock cash dividend, together totaling $59,221.25, would be reduced to $123,394.60.[12]

It is elementary that the *capital* interest of holders of *common* stock embraces not only the *amount invested*, but also the *surplus*, after all other liabilities, including preferred stock dividends, are provided for. If the dividends payable to holders of preferred stock are paid in cash as they accrue out of surplus available for dividends, as was done in the instant proceedings, then all of the remaining surplus profits constitute *capital* interest of holders of *common* stock only. Hence, when petitioners received the preferred stock as dividends, the outstanding preferred stock having received the dividend to which it was entitled, they merely received the evidence, in the form of preferred stock certificates, of their proportionate share in the surplus to the extent of such dividend. They received nothing in addition to what they theretofore had except such paper.

No money or other property out of corporate earnings or
50 profits accumulated after February 28, 1913, was distributed by the corporation and it merely capitalized a part of its surplus profits on its books of account. Nothing was taken from the

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account with corresponding credit to capital stock account, equal to the proposed "dividend"; the new stock is issued against this and the certificate delivered to the existing stockholders in proportion to their previous holdings. This, however, is merely bookkeeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; it affects only the form, not the essence, of the "liability" acknowledged by the corporation to its own shareholders, and this through a readjustment of accounts on one side of the balance sheet only, increasing capital stock" at the expense of surplus"; it does not alter the preexisting proportionate interest of any stockholder or increase the intrinsic value of the holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of shares, with consequent dilution of the value of each share.

A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.

The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.

We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital at the same time shows he has not realized or received any income in the transaction.

[12] These figures are taken from the record. See illustrative balance sheet and discussion thereof in dissenting opinion in James H. Torrens, 31 B. T. A. 787, 799, 801.

holders of preferred stock. Their capital interest to the extent of the par value of their shares was represented by assets of the corporation and they had no other interest, either capital or income, in the surplus, since they also received their quarterly dividend to which they were entitled on July 1, 1929, when the preferred stock was issued as a dividend on common stock.

These proceedings are distinguishable from *Tillotson Manufacturing Co.*, 27 B. T. A. 913 affirmed in Tillotson Manufacturing Co. v. Commissioner, 76 Fed. (2d) 189, relied upon by the majority.[13]

There is no adequate support in the record in James H. Torrens, 31 B. T. A. 787, also relied upon in the majority opinion, or in these proceedings, for the view that in the Tillotson case a dividend was declared "under substantially similar circumstances." The majority opinion there and here states, in effect, that a converse situation is presented as compared to that in the Tillotson case. This is tantamount to saying that the factual situation in the Tillotson case, as compared with the factual situation there and here, is different. No true stock dividend such as we have here is involved in the Tillotson case. Since the factual situations are thus different, it follows that the Tillotson case is distinguishable from the instant proceedings and the Torrens case upon the facts and in principle.

Furthermore, in the Tillotson case the court stated that "Two tests were thus established for distinguishing a taxable from a non-taxable dividend in stock: (1) Severance of assets from the corporation, and (2) alteration of the preexisting proportionate interest of the stockholders", and that there the first test, but not the second, was met. As appears from the discussion herein, in the instant proceedings both tests are met.

What is said in the Tillotson case, by the Circuit Court of Appeals and the Board, should be read in the light of its peculiar facts and should not be applied to a factual situation such as we have in the instant proceedings, which is so different, and the doctrine of the Tillotson case should not be carried beyond the requirements of the peculiar facts of that case.

51 The issuance of the preferred stock dividend in question here had no effect upon the rights of the preferred stock outstanding. It is elementary that ordinarily the *capital* interest of holders of preferred stock is limited to its par value, and that they have no *capital* interest in the surplus profits; that their interest in the surplus profits is limited to the fixed rate of dividend; that such interest is an *income* interest as distinguished from a *capital* interest; and that even a premium paid to holders of preferred stock upon redemption of such is not a *capital* interest, but constitutes *income* and is taxabale as such. Had the corporation, out of surplus, paid money or other property instead of stock, the assets of the corporation to that extent would have been depleted, but the

[13] The facts of the Tillotson case and the numerous grounds of distinction likewise applicable here are pointed out fully in the dissenting opinion in James H. Torrens, 31 B. T. A. 787, 799.

holders of the preferred stock outstanding could not have rightfully complained. Here the surplus was not distributed in money or other property, out of corporate earnings or profits accumulated after February 28, 1913, but was retained by the corporation. The asset side of the balance sheet was not affected. In fact, the corporation could have distributed the entire surplus to common stockholders in money or other property and the preferred stockholders would have had no right to complain. Even in that event the corporation would still have had assets equivalent to the par value of their stock, and, in addition, assets equal to the value of the amount invested by holders of common stock, which upon dissolution or liquidation is ordinarily subject to the rights of creditors and the preference of preferred stock. The owners of preferred stock previously outstanding were chargeable with knowledge that there was authorized unissued preferred stock which could be sold or issued as a dividend on common stock, as was done here. This must all be viewed in the light of the conditions that existed, in this respect, at the time of the declaration and payment of the stock dividend in question, and not in the light of any imaginary anticipated future changed condition. This question here can not be rightfully tested by different, assumed conditions as of some other time.

None of the Board cases which involve preferred stock dividends, except the Torrens case, are decided upon the *absence* or *existence* of previous outstanding preferred stock. As appears from the discussions herein, both are immaterial. There is nothing in the Constitution, revenue acts, regulations, rulings, or previous court or Board decisions which intimates that if there is preferred stock outstanding at the time of the issuance of a preferred stock
52 dividend such dividend is not a tax-free stock dividend; and all these require a result contrary to that reached by the majority here and in the Torrens case. The Torrens case should be overruled.[14]

It is elementary that fluctuations in value do not give rise to taxable income or deductible losses or constitute additional property rights by virtue of an increase in value; the measure of the value as reflected by the market may change, but the rights to all of the property remain the same whatever its value may be intrinsically or otherwise. The majority opinion does not mention a single thing *in esse*, in being, or of any actual value which the petitioners received from or which was distributed to them by the corporation on July 1, 1929, except the paper upon which the certificates were written. In some respects the majority opinion, in effect, holds taxable a thing *in posse*, that which is not but may be, something dependent upon conditions which can not be foreseen and wholly beyond the control of the corporation or its stockholders. The possibility that the petitioners may or may not receive a greater profit on the preferred stock than they would had they not received

[14] See dissenting opinion in James H. Torrens, 31 B. T. A. 787.

it is treated by the majority as "additional property rights which might well afford them a different and greater market with an increased money return." In Eisner v. Macomber, supra, however, the Court stated that "we regard the market price of the securities as an unsafe criterion and in an inquiry such as the present, *when the question must be*, not what will the *thing sell for, but what is it in truth and in essence.*" [Emphasis supplied.] By the receipt of the preferred stock dividend, the petitioners did not receive *in praesenti* anything in money or in other property, "out of its [corporation's] earnings or profits accumulated after February 28, 1913", as required by section 115 (a) of the 1928 Act, or any "of the company's assets for his [their] separate use and benefit", Eisner v. Macomber, supra, or any "assets of exchangeable and actual value severed from their capital interest" in the company, United States v. Phellis, 257 U. S. 156, or "a thing really different from what he [they] theretofore had", Weiss v. Stearn, 265 U. S. 242; and by a parity of reasoning the petitioners did not even receive any present "rights to the assets" of the company. Their right to future dividends is subject to declaration by the directors and their right to preference as to assets to the extent of the par value of their
53 stock and unpaid dividends, if any, can arise only at the time of liquidation.

The preferred stock received by the petitioners in the instant proceedings is a tax-free true stock dividend.

II

Hence the value of that stock on July 1, 1929, is immaterial.

Furthermore, in reconsidering the memorandum opinion entered herein on June 29, 1933, the Board is considering a new issue raised for the first time by respondent's motions filed July 18, 1933. The only issue raised by the pleadings in these proceedings is whether the preferred stock dividend distributed to the petitioners on July 1, 1929, was later redeemed or canceled by the corporation on October 1, 1929, in such a manner as to make the redemption or cancellation thereof equivalent to the distribution of a taxable dividend within the purview of section 115 (g) of the Revenue Act of 1928. Counsel for respondent so stated at the first hearing. The facts were there stipulated in part and such stipulation treats the dividend of July 1, 1929, as a "stock dividend." Hence the issue there presented did not comprehend the nature and character of the *dividend distributed on July 1, 1929*, but it involved only the nature and character of the *payment made on October 29, 1929*, by the company to the petitioners upon return to the company of the stock dividend distributed on July 1, 1929. This is admitted by counsel for respondent in his argument in support of his motions filed July 18, 1933, wherein he states:

"A stipulation filed with the Board refers to the dividend as a 'stock dividend', and it was on this theory that the deficiencies were determined and the cases presented to the Board."

Hence no question was raised by the parties as to the taxability of the stock dividend of July 1, 1929, until the respondent raised the question in the above motions. It was never raised except by motion and after the proceedings had been disposed of by the decision of June 29, 1933.

The respondent has not indicated that the memorandum opinion filed June 29, 1933, is incorrect in its statement of the issue raised by the pleadings and facts presented. On the contrary, in his brief in support of his motion for consideration and judgment filed
54 July 18, 1933, he stated that "the respondent was not complaining of the Division's decision on the theory on which it was presented and decided but was asking for reconsideration on a new theory" and that the "respondent is content with the findings of fact made by the Board in its previous memorandum Opinion * * *" filed June 29, 1933, except that under his new theory of the proceedings he, for the first time, with his motions, requested a finding as to the value of the preferred stock as of July 1, 1929, without any proof in the record to base such finding upon.

The question whether the stock dividend issued on July 1, 1929, was a tax-free stock dividend constitutes not a "theory", but an issue not raised by the pleadings; and such issue is a wholly different issue, governed by a wholly different statutory provision, section 115 (f) of the 1928 Act and not by section 115 (g) of the 1928 Act. These statutory provisions deal with wholly different causes. As this new issue and cause was not raised in the petition, the duty rested upon the respondent to plead it in his original answer or by amendment thereof under Rule 14 of the Board, which provides that the "answer shall be so drawn as *fully and completely* to advise the petitioner and the Board of the nature of the defense" and "shall contain * * * a statement of any facts upon which the Commissioner relies for defense or affirmative relief." While the question of the correctness of the deficiency is inherent in every proceeding before the Board, the Board, in determining the correctness of the deficiency, will consider only issues raised and causes pleaded (James P. Gossett, 22 B. T. A. 1279; John I. Chipley, 25 B. T. A. 1103; and Claude D. Cass, 32 B. T. A. —— (No. 103). No amendment to the pleadings was filed and the Board erred in ordering further hearing upon an issue and cause not raised by the pleadings. Coosa Land Co., 29 B. T. A. 389, 394; and North American Coal Co., 28 B. T. A. 807, 831. These cases, relied upon by the majority, do not hold that the Board, in determining the correctness of the deficiency, may consider issues or causes other than those raised by the pleadings. Furthermore, as heretofore indicated, all the facts necessary to sustain the respondent's new issue and cause in the instant proceedings were not adduced in evidence at the original hearing and it was necessary to hold a further hearing, after the proceeding had been heard and determined and its memorandum opinion
55 entered, to ascertain the fair market value of the preferred stock as of July 1, 1929.

The rule of the Board requiring the respondent, in his answer, to fully and completely advise the petitioner and the Board of the nature of his defense should not be permitted to be set at naught by designating an issue or a cause as a theory.

Assuming, for the purpose of discussion, that the issue and cause, under section 115 (f) of the 1928 Act, suggested for the first time by respondent's motions, constitutes a mere theory and not an issue or cause, neither the Board nor any Division could rightfully reconsider the memorandum opinion of June 29, 1933, or order the taking of further testimony without a showing on the part of respondent of newly discovered evidence or some other good cause therefor, which is lacking here. Fifth Avenue Bank of New York, Executor, 32 B. T. A. 208; Pierce Oil Corporation, 30 B. T. A. 470; and Fifth Street Building v. Commissioner, —— Fed. (2d) —— (May 13, 1935), affirming 24 B. T. A. 876.

No motion to amend the pleadings or reopen the proceedings to permit the taking of further proof was ever made by the respondent. See Pierce Oil Co., supra.[15]

In the instant proceedings, the hearing was concluded, briefs were filed, and an opinion completely disposing of the proceedings was rendered. All of respondent's motions as made should have been denied.

III

In view of the conclusions heretofore set forth, it is unnecessary to further discuss, directly or indirectly, whether (upon the whole record, under the provisions of the revenue acts[16] construed in the light of the reports of the committees of Congress[17]), (1) after the memorandum opinion had been entered on June 29, 1933, and after respondent's motion, filed July 18, 1933, for review by the Board upon the ground only that such memorandum opinion is contrary to Tillotson Manufacturing Co., 27 B. T. A. 913, was denied by order entered July 24, 1933, and after respondent's motions filed July 18, 1933, for reconsideration of such memorandum opinion and judgment for the respondent, upon the same ground, were denied after hearing thereon by the order entered January 15, 1934, with an accompanying "Memorandum",[18] not a "memorandum

56

[15] The Board there stated: "While Rule 17 does not define the *'conclusion of the hearing', it can not be said to extend beyond the time when the trial has been concluded and the briefs filed.* This we believe is a reasonable rule and fairness and orderly procedure require that it be adhered to in a case such as this. To disregard the rule under such circumstances would be an invitation to litigants to try their cases piecemeal and unreasonably extend the proceedings. Moreover, the petitioners here do not bring themselves within the rule, for the motion before us does not propose to 'amend the pleadings to conform to the proof', but seeks to reopen the case to amend the pleadings, and to offer proof in support of such amendment. * * *

"While the Board has not adopted a rule governing rehearing, its policy in respect thereto is that a rehearing is extraordinary, and *will only be granted on good cause shown.* * * *" [Emphasis supplied.]

[16] Sec. 900, 1924 Act; secs. 1000 and 1005, 1926 Act; secs. 601 and 272 (e), (h), 1928 Act.

[17] Rept. No. 2, Committee on Ways and Means, 70th Cong. 1st sess.; Rept. No. 960, Committee on Finance, 70th Cong., 1st sess.

[18] This "Memorandum" distinguishes the Tillotson case (27 B. T. A. 913) with less elaboration.

opinion", the order of January 31, 1934, should have been entered directing review by the Board of the "Order with the accompanying memorandum", dated January 15, 1934, upon another motion of respondent, based upon the same ground only, filed January 26, 1934, (a) that the Chairman of the Board direct that the "Memorandum Opinion entered by a Division of the Board on January 14, 1934" be reviewed by the Board, and (b) that if the decision of the Division had become the decision of the Board that the Board review its own decision; (2) whether the Board, upon such motion of respondent or upon its own initiative, should have considered the memorandum opinion entered June 29, 1933; (3) whether the Board should have directed another Division of the Board to enter the order dated November 20, 1934, vacating the order entered January 15, 1934, and granting respondent's motion filed January 26, 1934, for reconsideration of the memorandum opinion entered June 29, 1933; (4) whether such other Division should have entered the order dated November 24, 1934, placing these proceedings on the Chicago calendar for hearing evidence upon the subject of the fair market value of the preferred stock of the Hamilton Manufacturing Co., as of July 1, 1929; (5) whether another different Division should have heard such further evidence thereon February 13, 1935; (6) whether the memorandum opinion entered June 29, 1933, has become final so that the time for appeal by respondent has expired; or (7) any other phases of the proceedings.

57 *Conclusion*

In any event, the order of the Chairman dated January 31, 1934, and the orders of November 20 and November 24, 1934, should be vacated and set aside; both motions of respondent filed January 26, 1934, should be denied; the memorandum opinion entered herein on June 29, 1933, as well as the order of the Chairman dated July 24, 1933, and the order dated January 15, 1934, together with its accompanying memorandum, should be permitted to stand; and a decision should be entered in accordance with the memorandum opinion entered therein on June 29, 1933.

Since I presided at the first hearing in these proceedings and at the hearing on two of the three motions of respondent as filed July 18, 1933, and denied the same by the order of January 15, 1934; and, since I made the decision embodied in the memorandum opinion entered June 29, 1933, and dissented from the order entered November 20, 1934, and now dissent from the order of November 24, 1934, as well as from this opinion of the majority, I am constrained to respectfully set forth my views.

Before United States Board of Tax Appeals

(Caption—60890)

Decision

Entered Aug. 9, 1935

Pursuant to the Opinion of the Board promulgated June 27, 1935, the respondent on July 19, 1935, filed a proposed determination and notice of settlement which, after due notice, came on for hearing on August 7, 1935. Petitioner not having contested said proposed determination, it is

Ordered and Decided: That there is a deficiency of $5,831.67 in income tax for the year 1929.

[SEAL] (Signed) EUGENE BLACK, *Member.*

Entered Aug. 9, 1935.

j

58 Before United States Board of Tax Appeals

(Caption—60890)

Notice of Filing Petition for Review

Filed Nov. 8, 1935

To: Robert H. Jackson, Esq., Assistant General Counsel Bureau Internal Revenue, Washington, D. C., Counsel for Commissioner of Internal Revenue, Respondent:

Please Take Notice that the above named petitioner by his undersigned attorney, filed with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., on the 8th day of November, 1935, his petition for review by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Board rendered in the above entitled cause. A copy of the petition for review and of the assignments of error as filed with the Board is hereto attached and served upon you.

Dated this 8th day of November, 1935.

Respectfully,

(S) A. L. NASH,
Attorney for Petitioner, H. C. Gowran,
Manitowoc Savings Bank Bldg., Manitowoc, Wisconsin.

ACKNOWLEDGMENT OF SERVICE

Personal service of the foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein,

is hereby acknowledged as having been made on this 8th day of November, 1935.

(S) ROBERT H. JACKSON,
Assistant General Counsel, Bureau of Internal Revenue,
Counsel for Commissioner of Internal Revenue.

59 Before United States Board of Tax Appeals

(Caption—60890)

Petition for review by the United States Circuit Court of Appeals for the Seventh Circuit

Filed Nov. 8, 1935

To the Honorable Judges of the United States Circuit Court of Appeals for the Seventh Circuit:

Now comes H. C. Gowran, petitioner, by A. L. Nash, his attorney, and petitions this Honorable Court for review of the decision of the United States Board of Tax Appeals rendered and entered on August 9, 1935, in cause numbered 60890 on the docket of said Board, wherein the said H. C. Gowran was petitioner and the Commissioner of Internal Revenue was respondent; and in support of this petition respectfully shows this Honorable Court as follows:

I

Venue

The petitioner is an individual and a resident of the judicial circuit of this Honorable Court. The income tax return of the petitioner for the taxable year 1929 was filed in the office of the Collector of Internal Revenue for the District of Wisconsin, which office is, and was at the time said return was filed, located at the city of Milwaukee in the state of Wisconsin, within said judicial circuit.

The respondent is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States. The principal office of said Commissioner of Internal Revenue is located at the city of Washington, D. C.

II

Jurisdiction

The United States Circuit Court of Appeals for the Seventh Circuit has jurisdiction to review the said decision of the United
60 States Board of Tax Appeals by virtue of the provisions of Sections 1001, 1002, and 1003 of the Revenue Act of 1926 as

amended by Section 603 of the Revenue Act of 1928 and as further amended by Sections 1101 and 1102 of the Revenue Act of 1932, and as further amended by Section 519 of the Revenue Act of 1934.

III

Nature of controversy

This is a proceeding for review, by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the United States Board of Tax Appeals entered on August 9, 1935, sustaining a deficiency in income tax for the calendar year 1929 asserted by the respondent against the petitioner in the sum of $5,831.67.

The said deficiency tax was determined by the respondent and notice thereof was given to the petitioner by respondent's letter dated October 19, 1931, which letter was issued by respondent under the provisions of Section 272 of the Revenue Act of 1928. In said letter the respondent stated that a certain stock dividend received by petitioner during 1929 had been cancelled or redeemed by the issuing corporation at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution to petitioner of a taxable dividend, under the provisions of Section 115 (g) of the Revenue Act of 1928; and that the Commissioner's conclusion was that petitioner thereby had become liable for a deficiency tax in the sum of $5,831.67, based wholly on the distribution and subsequent cancellation or redemption of the stock dividend.

On December 16, 1931, and in accordance with Section 272 of the Revenue Act of 1928, the petitioner filed his petition with the United States Board of Tax Appeals, asking a redetermination of the deficiency determined by the respondent, and in his said petition alleged in substance that in determining petitioner's taxable net income for the calendar year 1929 the respondent has erroneously included therein additional income based on respondent's contention that the distribution and later cancellation or redemption of said dividend shares had been a transaction essentially equivalent to a taxable dividend received by petitioner.

In support of his petition, the petitioner showed the following facts:

61 1. On July 1, 1929, the corporation above mentioned distributed a stock dividend to its common stockholders. The dividend was paid entirely in shares of preferred stock of the corporation computed at the par value of said preferred shares, viz: $100.00 per share.

2. Petitioner received 533 (and a fraction) shares of such preferred stock, at par, as the result of the distribution of this stock dividend.

3. Every other common stockholder of the corporation received the same pro rata distribution of preferred shares, at the same time.

4. No common stockholder had any election, option or right to receive anything except the said preferred shares in payment of the dividend, and there was no representation by the corporation to any stockholder at any time that any part of the dividend shares would ever be redeemed in cash.

5. Petitioner sold his dividend shares to the corporation about three months after distribution of same, at $100.00 per share, the par value of the stock, which was less than the redemption price of same.

6. The transaction last described was not a redemption of its preferred stock by the corporation, but was a purchase of some of its outstanding preferred shares so that the same could be resold to other parties.

On February 5, 1932, the respondent filed with said United States Board of Tax Appeals his answer to the above described petition, by which answer respondent denied that he had committed any error in his conclusion as to the legality and amount of the proposed deficiency tax.

This cause by order of said Board of Tax Appeals was consolidated for hearing and decision with three others, Nos. 60891, 60892, and 60893. After hearing, a memorandum opinion was promulgated by said Board under date of June 29, 1933, holding in favor of petitioner and against the respondent on the issue joined by the original petition and answer, that is to say: holding that the distribution of a stock dividend in preferred shares of the corporation to the petitioner on July 1, 1929, had not been followed by the cancellation or redemption of said shares in such manner as to make the entire transaction the equivalent of a taxable dividend (under the provisions of Section 115 (g) of the Revenue Act of 1928).

On July 24, 1923, respondent's motion for review of the memorandum decision by the entire Board was denied.

62 On January 15, 1934, respondent's motion for reconsideration of the memorandum decision was denied by an order of a Division of the Board.

On January 31, 1934, the Chairman of the Board made an order providing for review by the whole Board of the order which denied respondent's motion for reconsideration.

On November 20, 1934, the Board made an order vacating the order dated January 15, 1934 (which denied respondent's motion for reconsideration) and granting such motion for reconsideration.

On November 24, 1934, an order was made by a Member of the Board whereby the cause was placed on the next circuit calender of the Board of Tax Appeals at Chicago, for hearing evidence limited to the fair market value of the preferred shares distributed to petitioner on July 1, 1929.

Thereafter, at Chicago, it was stipulated that the fair market value of said shares was $100.00 per share, being the same as the par value thereof.

On June 27, 1935, the Board promulgated its decision in this cause and the three other causes consolidated with it. This decision did not change or overrule the prior decision, dated June 29, 1933, whereby it was held that the preferred shares distributed as a dividend had not been redeemed in such a manner as to make the distribution and redemption essentially equivalent to a taxable dividend under Section 115 (g) of the Revehue Act of 1928. But the decision promulgated on June 27, 1935, disclosed that the Board of Tax Appeals now held that the original distribution of the dividend shares by the corporation to petitioner on July 1, 1929, was not a tax-free dividend, but that such distribution constituted taxable income of the petitioner at the time he received said preferred shares from the corporation, and the Board held in its said decision that the receipt by petitioner of said preferred shares constituted income of the petitioner because receipt of said preferred shares resulted in a change in the pre-existing proportionate interest of the stockholder in the corporation.

By its decision promulgated on June 27, 1935, the Board also denied three motions made by petitioner on February 13, 1935, which motions were (1) that the order of the Board dated November 20, 1934, whereby the Board granted reconsideration of its memorandum opinion of June 29, 1933, be vacated and set aside; (2) that respondent's motion for such reconsideration be denied;
63 and (3) that judgment be ordered for the petitioner in accordance with the prayer of his petition. Petitioner's said three motions were made on the ground that the memorandum decision of June 29, 1933, became the decision of the Board of Tax Appeals thirty days thereafter, since within said thirty days said decision was not reviewed by the whole Board, and that no petition for review by the United States Circuit Court of Appeals was filed by respondent within three months after said memorandum decision became the decision of the Board.

IV

Assignments of error

The petitioner says that in the record and proceedings before said United States Board of Tax Appeals, and in the decision and final order of redetermination rendered and entered by said Board in this cause, manifest error occurred and intervened to the prejudice of petitioner, and petitioner assigns the following errors, and each of them, which he avers occurred in the said record, proceedings, decision and final order of redetermination, to-wit:

1. The Board erred in entertaining and granting motions of respondent for reconsideration of the Board's memorandum opinion of June 29, 1933, whereby the issue in the cause then pending had been decided in favor of petitioner; said memorandum opinion having become the decision of the Board on July 29, 1933, and the

respondent not having, within three months thereafter, petitioned for review of such decision by the United States Circuit Court of Appeals.

2. The Board erred in denying petitioner's three motions filed on February 13, 1935.

3. The Board erred in holding that the distribution of preferred shares of Hamilton Manufacturing Company to petitioner on July 1, 1929, by way of stock dividend, was income of the petitioner and taxable as such.

V

Wherefore, being aggrieved by said holdings and conclusions of law contained in and set forth by the opinion of the Board dated June 27, 1935, and by the decision entered pursuant thereto
64 on August 9, 1935, petitioner prays that the decision of said Board be reviewed and reversed and that proper action be taken to the end that the errors complained of may be reviewed and corrected.

A. L. Nash,
A. L. Nash,
Attorney for Petitioner,
Manitowoc Savings Bank Building, Manitowoc, Wisconsin.

[Duly sworn to by A. L. Nash, jurat omitted in printing.]

Before United States Board of Tax Appeals

(Caption—60890)

Order enlarging time

Entered Dec. 26, 1935

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record sur petition for review of
65 the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to February 6, 1936.

(Signed) Eugene Black, *Member.*

Dated: Washington, D. C., Dec. 26, 1935.

jd

Now, February 24, 1936, the foregoing order enlarging time certified from the record as a true copy.

[SEAL] B. D. Gamble,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

(Caption—60890)

Order enlarging time

Entered Feb. 3, 1936

For cause appearing of record, it is

Ordered that the time for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit be and it is hereby extended to March 7, 1936.

(Signed) EUGENE BLACK, *Member.*

Dated: Washington, D. C., Feb. 3, 1936.

s.

Now, February ——, 1936, the foregoing order enlarging time certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

66 Before United States Board of Tax Appeals

(Caption—60890)

Praecipe for record

Filed Jan. 22, 1936

To the CLERK OF THE UNITED STATES BOARD OF TAX APPEALS:

You are hereby requested to prepare, certify, and transmit to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, in accordance with the rules of said Court, a transcript of the record in the above entitled proceeding and to include in said transcript of record copies duly certified as correct of the following:

1. Docket entries of all proceedings before this Board.
2. Pleadings before the Board, consisting of the petition and answer thereto.
3. Stipulation of facts signed by counsel for petitioner and respondent and filed with member of Board at Milwaukee on July 26, 1932.
4. Memorandum opinion promulgated June 29, 1933.
5. Motion by respondent filed July 18, 1933, whereby respondent moved for (1) reconsideration of the memorandum opinion entered June 29, 1933, (2) review by the Board of said memorandum opinion and (3) judgment for respondent.
6. Order entered July 24, 1933, denying motion for review of memorandum opinion of June 29, 1933.
7. Order denying respondent's motion for reconsideration of memorandum opinion of June 29, 1933, and denying respondent's motion

for judgment. (This order is dated January 15, 1933, but should be dated January 15, 1934.)

8. Order vacating order of January 15, 1934, and granting respondent's motion for reconsideration, dated November 20, 1934.

9. Motions of petitioner dated February 13, 1935, whereby petitioner moved (1) that the order of November 20, 1934, be vacated, (2) that respondent's motion for reconsideration be denied and (3) that judgment be ordered for petitioner.

10. Stipulation dated February 8, 1935, fixing fair market value of preferred stock of Hamilton Manufacturing Company as of July 1, 1929, signed by counsel for petitioner and respondent.

67 11. Opinion of Board promulgated June 27, 1935, with dissenting opinion by McMahon.

12. Decision of Board entered August 9, 1935.

13. Petition for review and notice of filing thereof with acknowledgment of service, filed by petitioner on November 8, 1935.

14. Board order enlarging time for transmission and delivery of the record, dated December 26, 1935. (Not included in record.)

15. This praecipe with acknowledgment by respondent of service thereof.

(Sgd.) A. L. NASH, *Attorney for Petitioner.*

ACKNOWLEDGMENT OF SERVICE

Service of a copy of the foregoing praecipe on the 18th day of January 1936 is hereby acknowledged.

(Sgd.) HERMAN OLIPHANT,
General Counsel for the Dept. of the Treasury,
Attorney for respondent.

Clerk's certificates to foregoing transcript omitted in printing.]

69 [Caption omitted.]

In United States Circuit Court of Appeals for the Seventh Circuit
No. 5801—October term, A. D. 1935

H. C. GOWRAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of a Decision of the United States Board of Tax Appeals

Motion for leave to file a brief as amicus curiae in opposition to the decision of the United States Board of Tax Appeals

Filed August 31, 1936

Now comes Roger S. Baldwin, an attorney and counsellor duly admitted to practice before the Supreme Court of the United States,

the Circuit Courts of the United States for the Second and Third Circuits, and the highest courts of the States of New York and of Connecticut, and represents that there is involved in this case the question of the proper interpretation of the provisions of the applicable Revenue Acts of the United States that "a stock dividend shall not be subject to tax." There are also involved the question as to whether or not the type of stock dividend present in this case is taxable as income under the 16th Amendment to
70 the Constitution of the United States and, if this Court should hold that the stock dividends involved are exempt from taxation, there is also involved the proper basis to use in determining the gain or loss from the sale or other disposition of the stock so received as a stock dividend.

These questions vitally affect the interests of three taxpayers who are clients of the undersigned, who are now involved in a controversy with the Treasury Department as to whether or not certain stock dividends received by them are subject to income taxation. The dividends in question, both in connection with such controversy and with this case, were paid in preferred stock on common stock. The United States Board of Tax Appeals has recently held in this and similar cases that such dividends are taxable. The tentative liability against the three taxpayers above referred to may amount to as much as $6,000,000. The decision and opinion in this case may determine the question of the taxability of such stock dividends.

As set forth in the attached affidavit of the undersigned, duly sworn to on the 26th day of August 1936, copies of the proposed brief will be furnished to Mr. A. L. Nash, the attorney for the Petitioner herein, and to the Honorable Robert H. Jackson, Assistant Attorney-General of the United States, attorney for the Respondent. Both attorneys have given their consent in writing to the filing by the undersigned of a brief amicus curiae herein. The letters of both attorneys signifying their consents are annexed to such affidavit.

The undersigned has not been admitted to practice before this Court, but will personally appear and request admission on or before the day on which this case is heard.

Therefore, he prays leave to file as amicus curiae a brief in opposition to the decision of the United States Board of Tax Appeals herein.

Respectfully submitted,

ROGER S. BALDWIN,
120 Broadway, New York, New York.

Dated, August 26, 1936.

71 In United States Circuit Court of Appeals

[Title omitted.]

Affidavit Supporting Motion for Leave to File Brief as Amicus Curiae

Filed Aug. 31, 1936

STATE OF NEW YORK,
County of New York, ss:

Roger S. Baldwin, having duly sworn, says that he was duly admitted and qualified on June 8, 1914, as an attorney and counsellor of the Supreme Court of the United States, on September 20, 1899, as an attorney of the Circuit Court of the United States for the Southern District of New York in the Second Circuit, on March 3, 1902, as an attorney and counsellor of the Circuit Court of the United States in the District of New Jersey in the Third Circuit, on November 8, 1897, as an attorney and counsellor at law of all the courts of the State of New York, including the highest court, of such state, and on January 31, 1919, as an attorney at the Bar of the several courts, including the highest court, of the State of Connecticut.

The undersigned proposes to move this Court for leave to file in this case a brief as amicus curiae in opposition to the decision of the United States Board of Tax Appeals which was in favor of the Respondent.

Copies of the brief which he proposed to file will be filed in this Court and will be furnished to the attorneys for the Petitioner and for the Respondent herein on or before September 10, 1936.

The attorneys for the Petitioner and for the Respondent herein have consented to the filing of such a brief by the undersigned. The letters containing such consents are annexed hereto, namely a letter, of Honorable Robert H. Jackson, Assistant Attorney-General of the United States, dated July 31, 1936, and a letter of A. L. Nash, Esquire, dated August 14, 1936.

ROGER S. BALDWIN.

72 Sworn to before me this 26th day of August, 1936.

[SEAL] M. Philip,
M. PHILIP,
Notary Public, Kings County.

Kings Co. Clk.'s No. 247, Reg. No. 7032. N. Y. Co. Clk.'s No. 65, Reg. No. 7 P 45.

Commission expires March 30, 1937.

In United States Circuit Court of Appeals

[Title omitted.]

Order granting leave to file brief as amicus curiae

August 31, 1936

It is ordered that Roger S. Baldwin be granted leave to file a brief in this cause as amicus curiae on or before September 10, 1936.

In United States Circuit Court of Appeals

[Title omitted.]

Motion for permission to file brief as amici curiae

Filed Nov. 18, 1936

73 Now come Allin H. Pierce, a member of the Bar of this Court, and Will R. Gregg, a member of the Bar of the State of New York, and move that the Court grant them permission to file a brief in this proceeding as amici curiae.

In support of their motion the undersigned say:

1. One of the issues involved in this case is the proper construction of section 115 (f) of the Revenue Act of 1928. That issue is one of importance and great public interest. The provisions of said statute have been incorporated in the Revenue Acts applicable to all years from 1921 to 1935 inclusive and the Court's decision in the case will involve the validity of numerous regulations and rulings of the Treasury Department promulgated over that period. The decision will affect both individuals and corporations.

2. The brief, which the undersigned ask leave to file as amici curiae, is confined to a discussion of the aforesaid issue. Particular attention has been given to recent developments which provide assistance in construing the aforesaid statute, i. e., the revised provisions of the Revenue Act of 1936 (approved June 22, 1936), and a recent decision of the Board of Tax Appeals (promulgated October 21, 1936).

3. The undersigned are attorneys for taxpayers who have cases pending before the United States Bureau of Internal Revenue, which involve facts similar to those in the present case, and which may be vitally affected by the decision in this case.

4. A copy of this motion and a copy of the brief, which the undersigned ask leave to file as amici curiae, have been delivered to the attorneys for each of the parties to this proceeding.

Wherefore the undersigned request that the Court grant them permission to file their brief in this cause as amici curiae.

ALLIN H. PIERCE,
WILL R. GREGG,
2 Wall Street, New York, New York.

November 18, 1936.

* * * * * * *

74 In United States Circuit Court of Appeals

[Title omitted.]

Order granting leave to file brief as amici curiae

November 18, 1936

It is ordered by the Court that Allin H. Pierce and Will R. Gregg be granted leave to file a brief in this cause as amici curiae.

In United States Circuit Court of Appeals

[Title omitted.]

Minute entry—November 18, 1936

Now this day come the parties by their counsel, and this cause comes on to be heard on the printed record and briefs of counsel, and on oral argument by Mr. A. L. Nash, counsel for petitioner, and by Mr. Morton K. Rothschild, counsel for respondent, and the Court having heard the same takes this matter under advisement.

* * * * * * *

75 In the United States Circuit Court of Appeals for the Seventh Circuit

No. 5801—October Term and Session, 1936

H. C. GOWRAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals

Opinion

Filed December 22, 1936

Before EVANS, Circuit Judge, and LINDLEY and BRIGGLE, District Judges.

LINDLEY, District Judge. Petitioner seeks a review of a decision of the Board of Tax Appeals approving respondent's assessment of a deficiency income tax against the petitioner for the year 1929.

Throughout 1929 petitioner was a holder of common stock in the Hamilton Manufacturing Company. On July 1st of that year, the corporation declared a dividend on the common stock of $14 per share and paid the same by distribution of shares of the corporation's preferred stock, at the par value of $100 per share. As his

dividend, petitioner received 533 shares. Previously he had held only common stock. At the time the dividend was declared the corporate earned surplus was $440,000, against which the total dividend, $261,531.00, representing 2,615 shares of preferred stock at $100, was charged.

Some three months after receiving the preferred stock, petitioner sold it to the corporation, at $100 per share. Petitioner, in filing his income tax return, apportioned a part of
76 the cost of his common stock to the preferred, treating the cost of the common as the total cost of both, and paid a tax on this basis. The commissioner assessed a deficiency tax, upon the premise that the completed transaction was essentially a cancellation or redemption of the preferred stock, equivalent to the distribution of a taxable dividend.

Petitioner filed his petition with the Board of Tax Appeals to set aside the commissioner's determination. The commissioner answered and, under date of June 29, 1933, a division of the board promulgated a memorandum opinion in favor of petitioner and against respondent, holding that the transaction did not amount to cancellation or redemption.

On July 16, 1933, respondent filed with the Board his motions for (1) reconsideration of the memorandum opinion, (2) review by the Board, as provided by Section 906 (d) of the Revenue Act of 1924, as amended by Section 1000 of the Revenue Act of 1926, and (3) judgment in favor of respondent. On July 24, 1933, respondent's motion for review was denied. On January 15, 1934, his motions for reconsideration of the memorandum opinion and for judgment were denied by Division 16. On January 26, 1934, respondent moved for review of the order denying respondent's motions for reconsideration and judgment, and five days later, the Board granted the review. Still later, on November 20, 1934, it disapproved the former order and granted respondent's motion for reconsideration of the memorandum opinion of June 29, 1933.

On February 13, 1935, petitioner filed with the Board three motions: (1) that the order of the Board dated November 20, 1934, whereby the Board granted reconsideration of the memorandum opinion of June 29, 1933, be vacated; (2) that respondent's motion for such reconsideration be denied; and (3) that judgment be entered for petitioner in accordance with the prayer of his petition for redetermination. On June 27, 1935, the Board delivered another decision. The opinion of the majority did not overrule the conclusions reached June 29, 1933, wherein it was held that the preferred shares had not been redeemed in such manner as to make the transaction essentially equivalent to a taxable dividend, but held that the original distribution was not a tax-free stock dividend, but consti-
tuted taxable income, because of the fact that the issue of the
77 shares resulted in a change in the proportionate corporate interests of the stockholders. The Board at that time denied petitioner's three motions made on February 13, 1935.

On August 9, 1935, the Board entered the decision from which this appeal is taken, approving the deficiency of $5,831.67 in income tax for the year 1929.

The facts are not disputed. The only questions submitted are those of law.

It is contended that the Board was without jurisdiction to decide the case upon a point not urged by the commissioner. The Board approved the commissioner's assessment but did so upon a legal theory different from his. We are of the opinion that the Board acted within its powers. It had a right to grant a rehearing. Washburn Wire Co. v. Commissioner, 67 F. (2d) 658 (CCA8); Helvering v. Continental Oil Co., 68 F. (2d) 750 (App. D. C.); Griffiths v. Commissioner, 50 F. (2d) 782; Bankers Coal Co. v. Burnet, 287 U. S. 308, 313; Burnet v. Lexington Ice & Coal Co., 62 F. (2d) 906 (CCA4); Helvering v. Louis, 77 F. (2d) 386 (App. D. C.). There was no abuse of discretion in doing so, for the Board may uphold the commissioner's decision for a different reason from that set up by the latter in his deficiency notice. This rule is particularly applicable where there is no dispute as to the facts. It is immaterial whether the commissioner proceeded upon the wrong theory. The burden is upon petitioner to show that the assessment is wrong, upon any proper theory; otherwise he must fail. Crowell v. Commissioner, 62 F. (2d) 51 (CCA6); Beaumont v. Helvering, 73 F. (2d) 110 (App. D. C.); J. & O. Altschul Tobacco Co. v. Commissioner, 42 F. (2d) 609 (CCA5).

No injury accrued to petitioner in this respect, as the stipulated facts covered all facts, including a value of $100 per share for the prefered stock. Consequently, there was no surprise of or advantage over petitioner.

The next question confronting us is the character of the distribution. Since the decision of the Board the Supreme Court on May 18, 1936, decided Koshland v. Commissioner, 298 U. S. 441, and there held that the issuance of common stock as a dividend upon preferred stock is a stock dividend which may be taxed; that where a stock dividend gives the stockholder an interest different in character from that which his former holdings represented, he receives taxable income.

In its previous holdings, Eisner v. Macomber, 252 U. S. 189,
78 and Towne v. Eisner, 245 U. S. 418, the Supreme Court had said that a common stock dividend did not in any wise alter the interest of a common stockholder. In the Koshland decision the court pointed out that a different result occurs when a different kind of stock is issued as a dividend. The legal quality of what the taxpayer has after such distribution, is different from that which he had before. Therefore, the distribution is one of property rights of variant character from those which he previously owned, and as such, therefore, constitutes income which could be taxed. The court, however, did not decide whether Congress has in fact levied a tax upon such kind of stock dividend. That question is now presented.

The Revenue Act of 1928, c. 852, 45 Stat. 791, expressly provides that stock dividends shall not be subject to tax, and the regulations have at all times, since said date, provided that the issuance of its own stock by a corporation as a dividend does not result in taxable income. This statute was enacted by Congress and the regulations of the Department were promulgated after the Supreme Court decided that dividends of common stock to common stockholders do not constitute income. Since that decision, it has been the settled policy in legislation and administration to make no assessment against such distribution as income. Since the Koshland decision, however, it is clear that there are two kinds of stock dividends—those which result in no change of interest in the corporate property and those which result in a new sort of interest. The latter is income and may be taxed.

But we find in the act nothing which will justify us in reading into it any implied intent upon the part of Congress to limit the term "stock dividend." Rather, we believe that it had not previously occurred to Congress that there are two kinds of stock dividend, one taxable and one not. This is confirmed by the fact that in 1936 Congress amended the act so as to make taxable such stock dividends as are taxable within the constitutional amendment. To say that Congress intended so to provide by prior legislation seems to us unjustified.

The situation then is this: A stockholder received in 1929 a stock dividend which might have been taxed if Congress had seen fit to do so. This Congress had not done. Consequently, petitioner received his preferred stock free of any tax. Upon its receipt, it became an asset of his estate. Thereafter within the same year, he sold
79 it. Consequently, he was bound to account for any profit realized in the sale. Such profit is taxed, and he must account for the same.

The material question is as to his cost basis for the determination of such profit. Petitioner urges that it is $100, the stipulated value at the time he received it. The government says it is zero.

We liken the receipt of the tax-free income in the present case to that of a tax-free gift, bequest, legacy or other tax-free addition to the taxpayer's estate. One who receives a tax-free gift and later sells it, in the absence of statute providing otherwise, is taxed upon the profit arising from the difference in its value at the time he receives it and the sale price. Similarly one who receives a tax-free bequest, when selling it, is taxed upon the profit arising from any excess of the sale price over its fair market value at the time of receipt. The measure of liability of the taxpayer here is to be determined by the same standard; his tax, in case of sale, is to be computed just as if the dividend had not been tax-free. He must account for any difference between the stipulated value of $100 and the selling price. If this property were added to his estate by inheritance, and if there were no laws taxing it, upon sale of the same, under the established

policy of the revenue laws of the United States, a tax would be assessed upon any profit resulting from a sale in excess of its value at the time he received it. The same yard-stick must apply here.

Consequently, the sale of the stock having been for the same amount as the fair cash market value at the time he received it, no profit resulted, and no tax liability exists. The decision of the Board of Tax Appeals is reversed with directions to proceed in conformity with this opinion.

80 In United States Circuit Court of Appeals

H. C. GOWRAN

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Decision of the United States Board of Tax Appeals

Judgment

December 22, 1936

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision entered in this cause on August 9, 1935, by the United States Board of Tax Appeals, be and the same is hereby reversed and that this cause be and the same is hereby remanded to the said United States Board of Tax Appeals with directions to proceed in conformity with the opinion of this Court.

Recital as to petition for rehearing

And afterwards, to-wit: on the eleventh day of January 1937, there was filed in the office of the Clerk of this Court a petition for a rehearing, which said petition for a rehearing is not copied here.

81 In United States Circuit Court of Appeals

[Title omitted.]

Order denying petition for rehearing

Jan. 12, 1937

It is ordered by the Court that the petition for rehearing in this cause be, and the same is hereby denied.

Recital as to issuance of mandate

And afterwards, to-wit: on the ninth day of February 1937, the mandate of this Court issued to the United States Board of Tax Appeals.

82 [Clerk's certificate to foregoing transcript omitted in printing.]

83 Supreme Court of the United States

Order allowing certiorari

Filed May 17, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 41,427. U. S. Circuit Court of Appeals, Seventh Circuit. Term No. 27. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* H. C. Gowran. Petition for a writ of certiorari and exhibit thereto. Filed April 12, 1937. Term No. 27 O. T. 1937.

U. S. GOVERNMENT PRINTING OFFICE: 1937

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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

H. C. GOWRAN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit entered in the above entitled cause on December 22, 1936, reversing a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 39) is reported in 32 B. T. A. 820. The opinion of the Circuit Court of Appeals is reported in 87 F. (2d) 125.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 22, 1936. A petition for rehearing was denied January 12, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a dividend by a corporation in its own preferred stock payable to holders of common, resulting in the alteration of the preexisting proportionate interests of the stockholders in the two classes of stock, constitutes taxable income to the taxpayer under Section 115 of the Revenue Act of 1928.

2. Assuming that such a dividend does not constitute taxable income at the time of its receipt, what is the correct cost basis of the dividend stock?

3. In the event that this Court should hold that the stock dividend in question was not taxable at the time of its receipt and that the cost basis of the dividend stock under the circumstances is not zero, the further question is presented whether the case should be remanded to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) dealing with the redemption of stock under such circumstances that it should be treated as equivalent to the distribution of a taxable dividend.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 15–18.

STATEMENT

The facts, as found by the Board [1] (R. 41–43), are substantially as follows:

H. C. Gowran, the taxpayer and respondent herein, resides at Two Rivers, Wisconsin (R. 41).

Hamilton Manufacturing Company, hereinafter referred to as the company, was incorporated on February 23, 1926, under the laws of Wisconsin. Article III of its "Articles of Organization" as amended on April 5, 1926, and on December 27, 1928, provides that the company's capital stock shall be divided into 10,000 shares of preferred stock of the par value of $100 each, entitled to a preferential cumulative dividend at the rate of 7 per cent per annum, payable out of net profits; and 30,000 shares of common stock without nominal or par value. Article III further provides that the holders of common stock shall have certain rights and powers, including voting rights, and that the company shall have the right to purchase and redeem any part or all of the preferred stock on the first of January or July in any year, by paying $105 for each share, together with accrued dividends,

[1] As distinguished from the report of a division of the Board. (R. 18.)

and that the preferred stock when so redeemed and canceled, may be reissued. (R. 41–42.)

On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by 30 individuals in amounts ranging from 1 share to 6,189 shares. Prior to that date its preferred stock, issued and outstanding, amounted to 7,155 shares held by approximately 300 individual stockholders. The taxpayer and the other petitioners before the Board held no shares of the company's preferred capital stock prior to July 1, 1929. On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05. (R. 42.)

On June 29, 1929, the company's board of directors, at a special meeting, adopted a resolution which, after setting forth that the company's surplus was in excess of $261,531.20, the total of a $14 per share dividend on 18,680.8 common shares outstanding, and that there remained unissued $261,600 par value preferred stock available for issue by way of stock dividend, provided in part as follows (R. 42):

> Resolved, by the Board of Directors of Hamilton Mfg. Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay

> and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz: $100.

Pursuant to this resolution the taxpayer, who owned 3,812.25 shares of common stock, received 533.715 shares of preferred (R. 42). The preferred stock so received by the taxpayer on July 1, 1929, had a fair market value of $100 per share on that date (R. 43).

Subsequent to September, 1929, the taxpayer agreed to sell to the company at par all the preferred stock issued to him as a dividend, and on or about October 1, 1929, the company purchased at par all such preferred stock, for resale to its employees (R. 43).

The case was originally heard by a division of the Board of Tax Appeals on the question whether the redemption of the stock previously declared as a dividend in the same taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928. While the division, consisting of a single member, had the case under consideration, the Board decided *Tillotson Mfg. Co.* v. *Commissioner* (27 B. T. A. 913, affirmed, 76 F. (2d) 189 (C. C. A. 6th)), in which it held that a dividend upon preferred shares payable in common was not

a tax-free stock dividend under Section 201 (f) of the Revenue Act of 1926. The Commissioner filed a motion for reconsideration in the instant case because of that decision, and the motion ultimately was granted. (R. 36–37.) The case was assigned to another division and subsequently reviewed by the Board, which held (two members dissenting) that the stock dividend in question was subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 (R. 45), and that accordingly it was not necessary to pass upon the question whether the redemption of the stock previously declared as a dividend in the same taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928 (R. 41).

The taxpayer appealed to the court below, which decided that the stock dividend in question, while constituting income under the Sixteenth Amendment, was not subject to tax under Section 115 (f) of the Revenue Act of 1928. With respect to the cost basis of the dividend stock, the court decided that it was the value of the stock at the time the taxpayer received the stock dividend, and overruled the Government's contention that the dividend stock had no cost basis because the stock cost the taxpayer nothing. As to the Government's alternative argument, under Section 115 (g) that the redemption of the stock was essentially equivalent to a taxable dividend, the court adopted the

original report of a division of the Board, although the case was afterwards reviewed by the entire Board, which expressly refrained from passing upon that question on the ground that its decision on the construction of Section 115 (f) rendered it unnecessary.

On January 11, 1937, the Government filed a petition for rehearing principally on the ground that the lower court erroneously gave effect to the report of a division of the Board after the case had been reviewed by the full Board, which apparently conflicted with the terms of Section 601 of the Revenue Act of 1928 providing that the report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board. The lower court denied the petition for rehearing on January 12, 1937.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividend in question was not subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 although it represented income under the Sixteenth Amendment.

2. In failing to hold that Section 115 (f) applies only to stock dividends that do not constitute income under the Sixteenth Amendment.

3. In holding that the cost basis of stock previously issued as a stock dividend, which was

exempt under Section 115 (f) at the time of receipt, is the value of the stock at the time it was received by the stockholder.

4. In holding that Section 115 (f) was intended to exempt the value of stock dividends from tax at the time they were sold as well as at the time of receipt.

5. In failing to hold that the cost basis of stock previously issued as a dividend, which might have been taxed as income under the Sixteenth Amendment at the time of receipt, is nothing because it cost the taxpayer nothing.

6. In refusing to remand the case to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) to the circumstances of this case.

7. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. Whether the term "stock dividend" in Section 115 (f) of the Revenue Act of 1928 was intended to mean any stock dividend or only a stock dividend that does not constitute income to the shareholder under the Sixteenth Amendment is an important question of Federal law which has not been, but should be settled by this Court. In *Koshland* v. *Helvering*, 298 U. S. 441, this Court decided that a stock dividend similar to that here involved constitutes taxable income under the Sixteenth Amendment. The *Koshland* decision overturned

long-established administrative practice and immediately the question arose whether subdivision (f), providing that a stock dividend shall not be subject to tax, should apply to stock dividends that represent income under the Sixteenth Amendment. In the *Koshland* case this Court left this question open and said that it was not necessary to decide for the purposes of that case whether Congress intended to exempt stock dividends that constituted income under the Sixteenth Amendment at the time of their receipt. The question is now squarely presented in this case and in the case of *Helvering* v. *Pfeiffer,* decided February 15, 1937 (C. C. A. 2d), in which a petition for a writ of certiorari is also being filed.

The decision of the lower court with respect to the construction of Section 115 (f) is believed to be erroneous. The legislative history of the provision clearly shows that Congress originally intended to tax stock dividends and yielded only after the decision of this Court in *Eisner* v. *Macomber,* 252 U. S. 189. The Congressional Committee reports relating to subdivision (f) as first enacted show that Congress felt that it was "required" to enact such a provision by the decision of this Court in *Eisner* v. *Macomber, supra.* Congress intended to tax all dividends, subject only to the exception that if a dividend did not constitute income under the Sixteenth Amendment it was not to be taxed.

2. The reasoning upon which the court below reached the conclusion that the basis for determining gain or loss was the value of dividend stock when received cannot be reconciled with the reasoning of this Court in the *Koshland* case. In that case this Court held that where a taxpayer sold preferred stock on which she had previously received a dividend in common stock, the cost basis of the original (preferred stock) could not be reduced, as provided in the Treasury Regulations, by allocating the cost between the common and the preferred. This Court held that the statutory basis was "cost" and that the cost of the original stock was what the taxpayer paid for it. Here, too, the statutory basis is cost, and since adherence to cost was required in the *Koshland* case, it appears to follow that cost is the basis here. Since the dividend stock was acquired without any new investment, and since no part of the original investment can be allocated to it, it seems to follow that the basis for determining gain or loss of the dividend stock is zero.

The theory on which the lower court held that the basis of the dividend stock was its value at the time the taxpayer received it, is that a stock dividend is expressly tax-free under Section 115 (f), and therefore it should be treated like tax-free gifts, bequests or legacies. The basis for tax-free gifts, bequests and legacies is prescribed by the statute and by regulations of long standing to be value at date of acquisition. There is no similar

provision applying to stock dividends, and there is no authority in the Circuit Court of Appeals to prescribe a basis which departs from the statute. Moreover the analogy between tax-free gifts, bequests and devises, on the one hand and stock dividends, on the other, is not apt because the reason for adopting the value at the time of acquisition as the basis for tax-free gifts, bequests and legacies is not present here. The specific exemption of the value of gifts, bequests and legacies would not be preserved unless the recipient were permitted to recover tax-free the value at the time of acquisition. Furthermore, the value of the gift is subject to a gift tax and the value of bequests and legacies is subject to an estate tax so that the value would be taxed twice, unless the basis for determining gain or loss were fixed as value at the time of acquisition. While double taxation is not invalid, it is clear that Congress did not intend to impose it in the case of gifts, bequests and legacies.

In dealing with stock dividends, as distinguished from gifts, bequests and devises, Congress has evinced no purpose to do more than required by the decision of this Court in *Eisner* v. *Macomber, supra.* Even should this Court hold that the statutory exemption applies to all stock dividends, it is clear that the exemption was not prompted by any purpose to exempt the value of such stock dividends but, on the contrary, that Congress desired to tax them if possible. If they are not taxable on

receipt and their value at that time is not taxable upon disposition, it is clear that complete immunity from taxation has been accomplished despite the purpose of Congress to tax them if possible. Thus, instead of relief from double taxation, as in the case of gifts, bequests and legacies, the adoption of value at the time of receipt as the basis for stock dividends will result in a complete exemption from tax.

3. The case should be remanded to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) of the Revenue Act of 1928, *infra*, p. 16, to the circumstances of this case. Section 115 (g) provides that if the redemption of stock is done at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend, the distribution should be treated as a taxable dividend. The lower court gave effect to the report of a division of the Board in regard to the application of Section 115 (g), although the case was later reviewed by the full Board. Under the terms of Section 601 of the Revenue Act of 1928, *infra*, p. 17, amending Section 906 (b) of the Revenue Act of 1924, the report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board. It was clearly erroneous for the lower court to give effect to the report of the division of the Board under the terms of Section 601 of the Revenue Act of 1928.

4. The Bureau of Internal Revenue advises that there are now pending before the Board of Tax Appeals seventeen cases involving approximately $3,000,000 in taxes, in which either the question of whether a stock dividend representing income under the Sixteenth Amendment is exempt at the time of its receipt or the question of cost basis of such stock when it is sold, is presented. Both questions are involved in the instant case inasmuch as the taxpayer sold the dividend stock during the same taxable year. None of the seventeen cases before the Board has so far been tried, so that it is not likely that a conflict of decisions of Circuit Courts of Appeals could arise within two or three years.

The Bureau of Internal Revenue also advises that there are pending in the Income Tax Unit cases for 1933, 1934 and 1935 in which several large corporations paid stock dividends in one class of stock to holders of another class aggregating about $28,000,000. It is impossible at this time to ascertain the amount of taxes involved, but it would probably amount to several million dollars. There are probably some small or closely held companies which have paid similar stock dividends on which no practical check can be made. Moreover the question of cost basis of dividend stock may arise in any case in which a taxpayer disposes of stock previously received as a dividend on another class of stock within the past twenty-four years. It is im-

possible to estimate the amount of tax involved in such cases, but it will probably be large.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Seventh Circuit should be granted.

STANLEY REED,
Solicitor General.

APRIL, 1937.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to

the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

SEC. 601. BOARD OF TAX APPEALS—PROCEDURE.

Sections 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

"SEC. 906. (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

"(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which

the chairman directs that such report shall be reviewed by the Board.

* * * * * *

Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

H. C. GOWRAN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 30) is reported in 32 B. T. A. 820. The opinion of the Circuit Court of Appeals (R. 56) is reported in 87 F. (2d) 125.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 22, 1936 (R. 60). A petition for rehearing was denied on January 12, 1937 (R. 60). The petition for certiorari was filed April

12, 1937, and granted May 17, 1937 (R. 61). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a dividend by a corporation in its own preferred stock payable to holders of common, resulting in the alteration of the preexisting proportionate interests of the stockholders in the two classes of stock, constitutes taxable income to the taxpayer under Section 115 of the Revenue Act of 1928.

2. Assuming that such dividend does not constitute taxable income at the time of its receipt, what is the correct cost basis of the dividend stock?

3. In the event that this Court should hold that the stock dividend in question was not taxable at the time of its receipt and that the cost basis of the dividend stock under the circumstances is not zero, the further question is presented whether the case should be remanded to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g), dealing with the redemption of stock under such circumstances that it should be treated as equivalent to the distribution of a taxable dividend.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 35–40.

STATEMENT

The facts, as found by the Board [1] (R. 32–33), are substantially as follows:

H. C. Gowran, the taxpayer and respondent herein, resides at Two Rivers, Wisconsin (R. 32).

Hamilton Manufacturing Company, hereinafter referred to as the company, was incorporated on February 23, 1926, under the laws of Wisconsin. Article III of its "Articles of Organization" as amended on April 5, 1926, and on December 27, 1928, provides that the company's capital stock shall be divided into 10,000 shares of preferred stock of the par value of $100 each, entitled to a preferential cumulative dividend at the rate of 7 per cent per annum, payable out of net profits; and 30,000 shares of common stock without nominal or par value. Article III further provides that the holders of common stock shall have certain rights and powers, including voting rights, and that the company shall have the right to purchase and redeem any part or all of the preferred stock on the first of January or July in any year, by paying $105 for each share, together with accrued dividends, and that the preferred stock when so redeemed and canceled, may be reissued (R. 32).

On July 1, 1929, the company's common capital stock issued and outstanding, amounted to 18,680.8 shares held by 30 individuals in amounts

[1] As distinguished from the report of a division of the Board (R. 14).

ranging from 1 share to 6,189 shares. Prior to that date its preferred stock, issued and outstanding, amounted to 7,155 shares held by approximately 300 individual stockholders. The taxpayer and the other petitioners before the Board held no shares of the company's preferred capital stock prior to July 1, 1929. On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05 (R. 32).

On June 29, 1929, the company's board of directors, at a special meeting, adopted a resolution which, after setting forth that the company's surplus was in excess of $261,531.20, the equivalent of a $14-per-share dividend on 18,680.8 common shares outstanding, and that there remained unissued $261,600 par value preferred stock available for issue by way of stock dividend (R. 32–33), provided in part as follows (R. 33):

> Resolved, by the Board of Directors of Hamilton Mfg. Company, that there be and there hereby is declared a dividend on all of outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of

> said preferred stock so distributed to be taken at its par value, viz: $100.

Pursuant to this resolution the taxpayer, who owned 3,812.25 shares of common stock, received 533.715 shares of preferred. The preferred stock so received by the taxpayer on July 1, 1929, had a fair market value of $100 per share on that date (R. 33).

Subsequent to September 1929 the taxpayer agreed to sell to the company at par all the preferred stock issued to him as a dividend, and on or about October 1, 1929, the company purchased at par all such preferred stock, for resale to its employees (R. 33).

The case was originally heard by a division of the Board of Tax Appeals on the question whether the redemption of the stock previously declared as a dividend in the same taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928. While the division, consisting of a single member, had the case under consideration, the Board decided *Tillotson Manufacturing Co.* v. *Commissioner* (27 B. T. A. 913, affirmed, 76 F. (2d) 189 (C. C. A. 6th)), in which it held that a dividend upon preferred shares payable in common was not a tax-free stock dividend under Section 201 (f) of the Revenue Act of 1926. The Commissioner filed a motion for reconsideration in the instant case because of that decision, and the motion ultimately was granted (R. 28). The case was assigned to

another division and subsequently reviewed by the Board, which held (two members dissenting) that the stock dividend in question was subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 (R. 35), and that accordingly it was not necessary to pass upon the question whether the redemption of the stock previously declared as a dividend in the same taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928 (R. 32).

The taxpayer appealed to the court below, which decided that the stock dividend in question, while constituting income under the Sixteenth Amendment, was exempted from taxation by Section 115 (f) of the Revenue Act of 1928. With respect to the cost basis of the dividend stock, the court decided that it was the value of the stock at the time the taxpayer received the stock dividend, and overruled the Government's contention that the dividend stock had no cost basis because the stock cost the taxpayer nothing (R. 59–60). As to the Government's alternative argument, under Section 115 (g), that the redemption of the stock was essentially equivalent to a taxable dividend, the court apparently adopted (R. 57, 60) the original report of a division of the Board, although the case was afterwards reviewed by the entire Board, which expressly refrained from passing upon that question on the ground that its decision on the construction of Section 115 (f) rendered it unnecessary (R. 32).

On January 11, 1937, the Government filed a petition for rehearing principally on the ground that the lower court erroneously gave effect to the report of a division of the Board after the case had been reviewed by the full Board, which apparently conflicted with the terms of Section 601 of the Revenue Act of 1928 providing that the report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board. The lower court denied the petition for rehearing on January 12, 1937. (R. 60.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividend in question was not subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 although it represented income under the Sixteenth Amendment.

2. In failing to hold that Section 115 (f) applies only to stock dividends that do not constitute income under the Sixteenth Amendment.

3. In holding that the cost basis of stock previously issued as a stock dividend, which was exempt under Section 115 (f) at the time of receipt, is the value of the stock at the time it was received by the stockholder.

4. In holding that Section 115 (f) was intended to exempt the value of stock dividends from tax at

the time they were sold as well as at the time of receipt.

5. In failing to hold that the cost basis of stock previously issued as a dividend, which might have been taxed as income under the Sixteenth Amendment at the time of receipt, is nothing because it cost the taxpayer nothing.

6. In refusing to remand the case to the Board of Tax Appeals for a determination with respect to the application of Section 115 (g) to the circumstances of this case.

7. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

1. The dividend in preferred stock paid upon the common stock held by respondent constituted income to respondent within the meaning of the Sixteenth Amendment as settled by this Court in *Koshland* v. *Helvering,* 298 U. S. 441. Such dividend was not exempt under Section 115 (f) of the Revenue Act, which provides that a stock dividend shall not be subject to tax. The intent of Congress will prevail even over the literal wording of a statute, and the intent was to exempt under Section 115 (f) only such stock dividends as were not within Congressional power under the Sixteenth Amendment.

2. The capital gains provisions of the Revenue Act of 1928 direct that the basis of the dividend shares shall be cost. Respondent paid nothing for

the dividend shares and may not, under the *Koshland* case, apportion part of the cost of the original shares to the dividend shares. Hence the cost basis is zero. The analogy of tax free gifts and legacies, relied upon by the court below, is not relevant. This question was properly passed on by the court below and is properly presented to this Court.

3. If this Court should decide against the petitioner on both of the preceding points, we submit that the case should be remanded to the Board of Tax Appeals to determine whether the redemption of the preferred stock was made at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928. In this case the corporation redeemed the preferred stock three months after it had been issued as a dividend and during the same taxable year. While this question was considered in the original report of the Board, that report was afterwards reconsidered and the final opinion of the Board did not purport to pass upon it. The lower court erroneously gave effect to the report of a division in a case which was vacated by the Board.

ARGUMENT

I

A DIVIDEND BY A CORPORATION IN ITS OWN PREFERRED STOCK PAYABLE TO HOLDERS OF COMMON CONSTITUTES TAXABLE INCOME TO THE TAXPAYER UNDER SECTION 115 (f) OF THE REVENUE ACT OF 1928

1. *Koshland* v. *Helvering,* 298 U. S. 441, held that the payment of a dividend in common stock to a preferred shareholder constituted receipt of income by the preferred shareholder within the meaning of the Sixteenth Amendment. The converse situation here presented of a dividend in preferred stock to a common shareholder is not materially different, and is controlled by the *Koshland* decision. The court below agreed with the Government on this point [2] (R. 58).

In the *Koshland* case, this Court drew a distinction between a stock dividend which works no change in the corporate entity, the same interest in the corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where a different type of shares is issued as dividends, whereby

[2] The Board's opinion in this case preceded this Court's decision in the *Koshland* case. However, in deciding that a preferred stock dividend on common constitutes income, the Board held that there was no material distinction between the instant case and *Tillotson Manufacturing Co.* v. *Commissioner*, 76 F. (2d) 189 (C. C. A. 6th), which, like the *Koshland* case, involved a common stock dividend on preferred (R. 33–34).

the proportional interest of the stockholder after the distribution is essentially different from his former interest.[3] The rule was announced that the payment of a dividend of new common shares on old common, conferring no different rights or interests than did the old—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old—does not constitute the receipt of income by the stockholder; but that where a stock dividend gives the stockholder an interest different from that which his former stock holdings represented, he receives income taxable as such under the Sixteenth Amendment. Here, of course, the dividend was not of new common shares to holders of old common. Moreover, it is clear that the preferred stock received by the respondent as a common stockholder conferred rights and interests new and different from those conferred by the common, thus giving respondent an interest different from that which his common stockholdings represented.

Respondent, prior to the dividend, held only common stock. The common stock was without nominal or par value. Only the common stock under any circumstances was entitled to vote. No dividends could be paid on common until all divi-

[3] It is unnecessary in this case, as it also was in the *Koshland* case, to consider the effect of a stock dividend paid to holders of a different class of stock where the dividend did not change the nature and amount of the stockholder's proportionate interests in the corporate assets.

dends present and in arrears had been paid on preferred. In liquidation, distributions on common were subject to prior payment of the par value of the preferred plus, in certain contingencies, any dividends in arrears on the preferred. On the other hand, the preferred stock received by the respondent as a dividend had a par value of $100 per share, was redeemable at $105 plus accrued dividends, was non-voting, and was entitled to an annual preferential cumulative dividend of seven per cent and prior payment on liquidation as aforesaid (R. 9–11, 32).

Just prior to the dividend, the corporation's outstanding common stock amounted to 18,680 shares, of which respondent held 3,812 shares.[4] The preferred stock outstanding consisted of 7,155 shares, of which respondent held none.[5] The total dividend received by common shareholders consisted of 2,615 shares of preferred, of which respondent received 533 shares. Thus respondent, before the dividend, held 3,812 shares of common subject to asset preferences of 7,155 shares of preferred, totaling $715,500 in par value, and an annual preferred dividend charge of $50,085; but

[4] Fractions are omitted in this discussion.

[5] The common and preferred stockholders were substantially different groups, if not entirely so. The common was held by 30 individuals, whereas the preferred was held by approximately 300 individuals. Four individuals, including respondent, who owned 14,453 shares of the total of 18,680 shares of common outstanding, owned no preferred (R. 32–33).

after the dividend held his shares of common stock subject to asset preferences of 9,770 shares of preferred totalling $977,000 in par value, and an annual preferred dividend charge of $68,390. Cf. *Marr* v. *United States,* 268 U. S. 536, 541. Moreover, in addition to the change in the nature of the proportional interest in the net assets and income of the corporation represented by the common shares, respondent acquired for the first time the new and different interest represented by the 533 shares of preferred received as a dividend. The preferred shares gave respondent an interest in net assets of $53,300, and an annual cumulative right to $3,731 in dividends, subject to no priorities, So, too, as a result of the dividend to respondent and other common shareholders, the proportional interests of preferred stockholders in the net assets and income of the corporation were materially altered. Whereas before the dividend the group of three hundred preferred stockholders held the whole preferred stock equities, after the dividend, the group held but seventy-three percent of the preferred stock equities, the balance of twenty-seven percent going to the common shareholders, including respondent (R. 32–33). The preferred stock received by the respondent was thus income within the meaning of the Sixteenth Amendment as settled by the *Koshland* decision.[6]

[6] It would be no answer to argue that respondent received no income because the value of respondent's shares of common decreased in proportion to the value of the preferred

2. The question becomes one of whether the dividend received by respondent, which clearly constituted income within the meaning of the Sixteenth Amendment, was taxed by Congress at the time of its receipt. Subdivision (f) of Section 115 provides that "a stock dividend shall not be subject to tax." It probably will be argued that the dividend here in question is within the literal meaning of subdivision (f), and that this is an end of the matter. But, as Mr. Justice Holmes, speaking for the Court in *Boston Sand Co.* v. *United States,* 278 U. S. 41, 48, has said, the rule that "when the meaning of language is plain we are not to resort to evidence in order to raise doubts * * * is rather an axiom of experience than a rule of law, and does not preclude consideration of persuasive evidence if it exists." Accordingly, this Court has repeatedly held that it is its duty to give effect to the intent of Congress, and that such intent will prevail even over the literal meaning of a statute. *Hawaii* v. *Mankichi,* 190 U. S. 197, 212; *Ozawa* v. *United States,* 260 U. S. 178, 194; *Barrett* v. *Van Pelt,* 268 U. S. 85, 90. And, with specific reference to the income tax statutes, this Court in *Helvering* v. *New York Trust Co.,* 292 U. S. 455, 464, after recognizing the rule that a statute which

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stock dividend received. Even if this were the fact, such is the normal effect of any dividend, whether paid in cash or not. *United States* v. *Phellis,* 257 U. S. 156, 171; *Rockefeller* v. *United States,* 257 U. S. 176, 183.

contains no ambiguity must often be taken literally, said:

> But the expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history would often defeat the object intended to be accomplished.

Particularly is this the case with respect to the Federal income tax statutes. The particular provisions of a single statute cannot be supposed to be the product of a single draftsman writing at a given moment; the provisions have their roots in earlier statutes, and their modifications are the result of practical experience or judicial decision. This Court has definitively recognized that the construction of a tax statute necessarily involves consideration of the pre-existing tax history. It was stated in *Helvering* v. *Morgan's, Inc.*, 293 U. S. 121, 126:

> But the true meaning of a single section of a statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history of the income tax legislation of which it is an integral part.

See also *Ozawa* v. *United States, supra, Brown* v. *Duchesne*, 19 How. 183, 194.

We submit, if Section 115 (f) be viewed in the light of the previous legislation and judicial deci-

sions upon the question of stock dividends, that it must be taken to mean that only such stock dividends were exempted from taxation as could not be reached within the constitutional power of Congress.[7]

In the Revenue Act of 1913, the first act after the Sixteenth Amendment, Congress defined income as including dividends.[8] But this Court decided in *Towne* v. *Eisner*, 245 U. S. 418, that a dividend on common stock payable in common stock was not income under the 1913 Act. Thereupon in the Revenue Act of 1916, Congress promptly provided in express words that a stock dividend should be considered income to the amount of its cash value.[9] However, *Eisner* v. *Macomber*, 252 U. S. 189, decided in 1920, held that the statute exceeded constitutional power and that a dividend in common stock paid to holders of common stock was not income within the meaning of the Sixteenth Amendment. Accordingly, in the Revenue Act of

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[7] In *Koshland* v. *Helvering*, 298 U. S. 441, the Government argued that this provision must be read literally to exempt from taxation stock dividends of whatever nature. The argument was in considerable part based upon the assumption that the administrative construction of the provision must be given controlling weight in the construction of the statute. This Court did not pass on this question; it did, however, rule (pp. 446–447) that the Treasury Regulations were, in a cognate aspect, invalid. (See *infra*, pp. 23–24.) Our interpretation of the statute has accordingly been revised.

[8] Section II (B), c. 16, 38 Stat. 114, 166, 167.

[9] Section 2 (a) c, 463, 39 Stat. 756, 757.

1921 Congress enacted for the first time the provision that a stock dividend shall not be subject to tax.[10]

The reason for the enactment of the provision exempting stock dividends was compliance with the decision of *Eisner* v. *Macomber*. The House committee report on the Revenue Act of 1921 (H. Rep. No. 350, 67th Cong., 1st Sess., p. 8) states:

> Section 202 (which was finally enacted as Section 201 (d)) modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of Supreme Court in *Eisner* v. *Macomber*.

Senate Report No. 275, 67th Congress, 1st Session, page 9, similarly states that the exemption was required by *Eisner* v. *Macomber*. This Court has recognized that "the reason for the exemption was the decision in *Eisner* v. *Macomber*." *Koshland* v. *Helvering, supra,* at p. 444.[11]

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[10] Section 201 (d), c. 136, 42 Stat. 227, 228. The provision exempting stock dividends, repeated in intervening acts, finally became Section 115 (f) of the Revenue Act of 1928.

[11] In the *Koshland* case the question of whether Congress had taxed such stock dividends as were within its constitutional power was expressly left open. *Koshland* v. *Helvering, supra,* at p. 446. Accordingly, the statement in the opinion (p. 445) that the Treasury and Congress gave *Eisner* v. *Macomber* "a broader interpretation" must be taken to mean, as stated in the preceding paragraph of the opinion (p. 444), that the exemption was "broadly *phrased*." [Italics added.]

Thus the policy and object of the exemption was to comply with the Constitution as interpreted in *Eisner* v. *Macomber*. There is no evidence in the legislative history of the Revenue Act of 1921, or subsequent revenue acts, of a policy behind the exemption of stock dividends other than recognition of a constitutional limitation. Nor do we believe that any other policy of exemption can reasonably be imagined. That the object of Congress in providing the exemption was no broader than meeting constitutional limitation is further evidenced by the fact that in the Revenue Act of 1921, and all revenue acts thereafter, Congress sought to reach distributions which might otherwise be exempted under *Eisner* v. *Macomber* by providing that stock dividends redeemed under such circumstances as to constitute payment of a taxable dividend should be taxed as such.[12] Moreover, the evident

[12] Sec. 201 (d) of the Revenue Act of 1921, 42 Stat. 227, 228; Sec. 201 (f) of the Revenue Act of 1924, 43 Stat. 253, 254; Sec. 201 (g) of the Revenue Act of 1926, 44 Stat. 9, 11; Sec. 115 (g) of the Revenue Act of 1928, 45 Stat. 791, 822; Sec. 115 (g) of the Revenue Act of 1932, 47 Stat. 169, 204; Sec. 115 (g) of the Revenue Act of 1934, 48 Stat. 680, 712; Sec. 115 (g) of the Revenue Act of 1936, 49 Stat. 1648, 1688.

It may be argued that Congress adopted the redemption provision in lieu of taxing any stock dividends, whether exempt under the Constitution or not. But it is significant to note that in the Revenue Act of 1936, where Congress expressly limited the stock dividend exemption to such stock dividends as were not income within the meaning of the Sixteenth Amendment, the redemption provision is retained. See Section 115 (g) of the Revenue Act of 1936, 49 Stat. 1648, 1688.

intent of Congress in income taxation is to use its power under the Sixteenth Amendment to the full extent. *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *Helvering* v. *Stockholms Bank,* 293 U. S. 84, 89; *Irwin* v. *Gavit,* 268 U. S. 161. It is unreasonable to suppose that Congress at the same time and for no apparent reasons of policy intended to exempt stock dividends which were within its taxing power. This Court will not presume an arbitrary largess on the part of Congress. Grants of immunity from taxation are always strictly construed, *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491, and will not be applied beyond the policy sought to be effected, *Helvering* v. *Stockholms Bank, supra.* Here the only policy and reason for enactment of the exemption of stock dividends was compliance with constitutional limitation.

Finally, a short time after the decision of this Court in the *Koshland* case, Congress, in Section 115 (f) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, 1688, specifically provided that a distribution made by a corporation to its shareholders in its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment. On the floor of the House, Representative Vinson, majority member of the Committee on Ways and Means, which reported the 1936 Act, was engaged

in explaining the provisions of that Act when the following significant colloquy occurred:

> Mr. TREADWAY. May I ask the gentleman one question?
>
> I think he has covered subdivision (j) very thoroughly. Now, referring to section (f), taxable stock dividends, which is, of course, entirely new, that is, the principle is entirely new in that there is a set-up there under which stock dividends can be taxed, which has not been in the previous law. I am correct in that?
>
> Mr. VINSON of Kentucky. If the gentleman from Massachusetts will permit, under the 1934 act there was a provision that said no stock dividend should be taxed. In a very celebrated case, Eisner against Macomber, the Supreme Court held that the tax dividend involved in that case was not taxable. Out of that case grew up the idea that no stock dividend was taxable. I think it was because of that notion that the language to which I have referred, as appears in the 1934 bill, found its way there; that is, that no stock dividend should be taxed.
>
> *The proposed plan does not change the law* and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder.[13] [Italics ours.]

[13] 80 Cong. Rec. 6309 (1936). See also the discussion immediately following the response of Representative Vinson,

The Congressional understanding that the 1936 Act did not change the law is a factor of great weight in construing the prior acts of Congress on the same subject. *Tiger* v. *Western Investment Co.*, 221 U. S. 286, 309; *Cope* v. *Cope*, 137 U. S. 682, 688; *United States* v. *Freeman*, 3 How. 556. The change in language in Section 115 (f) in the 1936 Act does not indicate a change in law, but amounted to a clarification of existing law in order more certainly to effect what has always been the intent and policy of Congress—to exempt such stock dividends as are not within Congressional power and no more.[14] Cf. *Burnet* v. *Guggenheim*, 288 U. S. 280, 283; *Helvering* v. *N. Y. Trust Co.*, *supra*, at pp. 468–469. We therefore submit that the dividend received by respondent, since it was not constitutionally exempt, was taxable at the time of its receipt under the only construction of the statute which gives proper weight to the purpose of Congress.

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which we have quoted above, to the effect that the proposed plan does not change the law. *Id.* pp. 6309–6310. House and Senate reports, and debate in the Senate on the 1936 Act contain no pertinent discussion of the stock dividend provisions, except possibly 80 Cong. Rec. 8811.

[14] The argument may be made that it is not to be presumed that Congress took such "nugatory" action as to exempt only those stock dividends which are constitutionally exempt. But Congress clearly took such "nugatory" action in Section 115 (f) of the Revenue Act of 1936. Legislative statement of a constitutional exemption occurs not infrequently. For example, Congress has consistently exempted from taxation the income accruing to a state, or political subdivision thereof, from the exercise of an essential gov-

Our position is supported by the decision in *Tillotson Manufacturing Co.* v. *Commissioner*, 27 B. T. A. 913, aff'd, 76 F. (2d) 189 (C. C. A. 6th), which apparently was approved by this Court in the *Koshland* case.[15] Both the court below and the Circuit Court of Appeals for the Second Circuit in

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ernmental function. Revenue Act of 1913, 38 Stat. 114, 172; Revenue Act of 1916, 39 Stat. 756, 767; Revenue Act of 1918, 40 Stat. 1057, 1066, Revenue Act of 1921, 42 Stat 227, 238; Revenue Act of 1924, 43 Stat. 253, 268; Revenue Act of 1926, 44 Stat. 9, 25; Revenue Act of 1928, 45 Stat. 791, 823; Revenue Act of 1932, 47 Stat. 169, 205; Revenue Act of 1934, 48 Stat. 680, 712; Revenue Act of 1936, 49 Stat. 1648, 1689.

[15] In the *Tillotson* case, the Board, speaking through Member Sternhagen, was careful to point out that the exemption in subdivision (f) was no broader than the decision of this Court which caused the enactment. The Board said (p. 918):

"When it is realized that the occasion for the original prototype of section 201 (f), namely, section 201 (d) of the Revenue Act of 1921, exempting stock dividends from tax, was the decision of the Supreme Court in *Eisner* v. *Macomber*, *supra*, annuling so much of section 2 (a) of the Revenue Act of 1916 as included stock dividends among those taxable, it becomes clear that the subsequent statutory exemption was only as broad as the decision, and hence that the intention was not to exempt stock dividends by any general or loose concept but only such as could not constitutionally be taxed because they were not income. The term 'stock dividend' is not of itself so free from ambiguity as to preclude construction, and hence the statutory exemption must be construed to promote the intendment disclosed by the history and circumstances of its enactment. This requires that it be confined to such as have the attributes which distinguished them from the receipt of income by the shareholder. Only those which place the shareholder in no essentially different position are exempt."

Pfeiffer v. *Commissioner*, 88 F. (2d) 3, now pending in this Court, No. 29, October Term, 1937, relied upon a literal reading of subdivision (f), and Treasury regulations (see Article 628 of Regulations 74, *infra*, p. 40) and administrative rulings, which are susceptible of the interpretation that all stock dividends, even though not constitutionally exempt, are within the meaning of subdivision (f). But the intent of Congress will prevail even over the literal meaning of a statute, and such intent can no less prevail over administrative interpretation. Moreover, the administrative interpretation of the meaning of "stock dividend" in subdivision (f) was at all times integrated with the apportionment of the cost basis of the original stock between the original stock and the stock received as a dividend thereon. Such apportionment this Court in the *Koshland* case held to be invalid. The broad interpretation of the stock dividend exemption, inextricable from the invalid apportionment of original cost, must also necessarily fail. Judge Learned Hand, dissenting in *Pfeiffer* v. *Commissioner, supra,* states the matter pungently:

> There has therefore never been any administrative interpretation of section 115 (f), so far as I can find, which did not immediately connect it with this method of calculating the "basis"; unless perhaps Article 115–10 (1) of Regulations 86 and its prede-

cessors may be counted."[16] I do not know how far I should have thought these provisions as a whole conclusive; and it is of no consequence, for *Koshland* v. *Helvering, supra,* 298 U. S. 441, 56 S. Ct. 767, 80 L. Ed. 1268, 105 A. L. R. 756, has settled it that so far as they affect the "basis", they have been invalid from the beginning. Thus, the only question now is whether though invalid as to that, they may still be authoritative in interpreting section 115 (f) taken alone. I cannot think that we should blow hot and cold; if the effort indirectly to charge the taxpayer with the new shares under the guise of diminishing his "basis" must break down, any concomitant interpretation as to exemption of the shares, qua income, ought to fall with it. * * *

[16] [Our footnote.] Article 115–10 (1) of Regulations 86 does not purport to interpret the meaning of subdivision (f) but merely provides:

"ART. 115–10. Source of tax-free distribution of stock or securities in corporate reorganization: The general rule provided in section 115 (b), that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:

"(1) A stock dividend. See section 115 (f)."

II

ASSUMING THAT THE STOCK DIVIDEND IN THIS CASE DOES NOT CONSTITUTE TAXABLE INCOME AT THE TIME OF ITS RECEIPT, THE CORRECT COST BASIS OF SUCH STOCK IS ZERO

If this Court should decide that the dividend of preferred stock, although income under the Sixteenth Amendment, was exempt under Section 115 (f) and so was not taxable when received, we submit as an alternative argument that the entire proceeds of the sale of the preferred by respondent to the corporation (R. 33) represented taxable gain.

1. The *Koshland* case presented essentially the same situation as that here: the receipt by the taxpayer of a stock dividend which constituted income under the Sixteenth Amendment. The question there arose as to what the basis should be upon sale by the taxpayer of the original shares, with respect to which the dividend was declared. This Court pointed out that the relevant capital gains provisions of the Revenue Act of 1928, Sections 111 (a) and 113, *infra*, pp. 35–37, plainly required a cost basis, that the requirement of a cost basis could not be changed by regulation, and held that the cost of the original shares could not be apportioned between the original shares and the dividend shares. Here respondent sold the dividend shares, and under the same plain provisions of the Revenue Act of 1928 the basis for such shares must be their cost. But

the respondent paid nothing for the dividend shares, and since the cost of the original shares may not under the *Koshland* decision be apportioned to the dividend shares the cost basis of the dividend shares is necessarily zero. Hence the entire proceeds of the sale of the dividend stock to the corporation constituted taxable gain.

The court below decided that the basis of the dividend stock was its value at the time of receipt by respondent. That result was predicated upon an analogy to tax-free gifts and legacies. The basis for tax-free gifts and legacies is specifically prescribed by statute. But there are no similar provisions applying to stock dividends, and nowhere in the applicable Revenue Act of 1928 is there authority to depart from the plain requirement of Section 113. Bases for gifts and legacies are provided for by Section 113 in the form of exceptions to the rule laid down in that section that the basis upon disposition of property acquired after February 28, 1913, shall be cost. This Court noted in the *Koshland* case (p. 446) that the exceptions to the Section 113 requirement of cost basis have no relevance in a situation such as that here presented. Moreover, the analogy between tax-free gifts [17] and devises on the one hand and

[17] It should be noted that at least so far as gifts made after December 31, 1920, are concerned Section 113 (a) (2) provides not for a basis of fair value at the time of receipt but for the same basis as that of the donor or last preceding owner not acquiring the property by gift.

stock dividends on the other is not apt, because the reason for adopting the value at the time of acquisition as the basis for gifts and legacies is not present here. The value of a gift is subject to a gift tax and the value of legacies is subject to an estate tax. Hence, gifts and legacies would be subjected first to an estate or gift tax and then to an income tax upon capital gain, unless the basis for determining gain or loss were value at the time of acquisition. While double taxation is not invalid, Congress clearly followed a policy of avoiding what would in substance be double taxation of gifts and legacies. But there is no occasion for or evidence of a similar policy in the case of stock dividends. Here, instead of relief from double taxation, the adoption of value at the time of receipt as the basis for the dividend shares will result in a complete exemption from tax for no apparent reasons of policy at all.

2. The respondent suggests (Br. in opp. 6–7) that the question of the cost basis of the preferred stock has not been properly raised. The Circuit Court of Appeals passed upon this question (R. 59–60), and it is presented to this Court in the petition for certiorari (Pet. 10–12). The record contains all the facts necessary to a decision. There was no want of power in the court below, nor would there be any lack of power in this Court, to pass upon this question, which is clearly one of law alone with no mixed element of fact. *Langnes* v. *Green*, 282 U. S. 531, 537–538. In the light of the circum-

stances of the litigation, we submit that the court below properly passed upon the question.

The taxpayer's return showed a capital net gain in the amount of $27,262.72, reporting profit realized on the redemption of 533.715 shares of Hamilton Manufacturing Company preferred stock. The Commissioner determined that the redemption was essentially equivalent to the distribution of a taxable dividend under Section 115 (g), and hence eliminated the capital gain, and increased income from dividends in the amount of $53,371.50 (R. 5–7).

After the filing of pleadings before the Board, and during consideration by Board Member McMahon of the issue of the redemption as a taxable distribution under Section 115 (g), the Board on March 11, 1933, decided the *Tillotson* case, *supra*. Accordingly the Commissioner advanced the argument sustained in that decision that a dividend such as that in question is taxable at the time of its receipt. The *Tillotson* case was affirmed by the Circuit Court of Appeals for the Sixth Circuit on March 14, 1935. On June 27, 1935, the Board followed the *Tillotson* case and agreed with the Commissioner that the dividend was taxable at the time of its receipt. In view of the *Tillotson* decision by the Board, and its affirmance in the Sixth Circuit, the Commissioner reasonably relied before the Board on the theory that the dividend was taxable at the time of its receipt. There was then no occasion to make the alternative argument premised upon

error in the theory that the dividend was taxable as income at the time of receipt. But if the Board had refused to follow the *Tillotson* case and had decided that the dividend was not taxable as income, there could have been little question of the propriety of the Board's granting a hearing to the Commissioner on the question of the cost basis which would have then been raised because of the Board's adverse decision.

The appeal in this case was to the Seventh Circuit, and before argument in the court below, this Court in the *Koshland* case had prescinded the question of the taxability of the dividend as income at the time of receipt. Accordingly, the Commissioner diligently anticipated a possible adverse decision on that question and argued the question of cost basis as a resulting alternative. The position of the taxpayer was in no way prejudiced by the presentation of the cost basis question since it was one of law, and taxpayer, who was afforded opportunity to answer the argument, could have added no new facts in support of his position had the question been presented before the Board. The absence of prejudice to the taxpayer is further demonstrated by the fact that the decision of the court below on the cost basis question was favorable to the taxpayer. Nor was the Commissioner seeking to secure a *reversal* of the Board's decision on a theory not presented to it. *General Utilities Co.* v. *Helvering,* 296 U. S. 200, and *Helvering* v. *Salvage,* 297 U. S. 106, are thus inapplicable. The

situation is rather to be viewed as an example of the familiar rule that any argument may be offered in support of the judgment below.[18] *United States* v. *American Ry. Express Co.*, 265 U. S. 425, 435–436; *Langnes* v. *Green*, 282 U. S. 531, 537–538; *Stelos Co.* v. *Hosiery Corp.*, 295 U. S. 237, 239. As such, and in view of all the circumstances, the court below properly passed on the argument of cost basis.

Finally, the court below has decided the question of cost basis, and we submit, erroneously. Should this Court decide against the Government on the taxability of the dividend at the time of receipt, clearly it would be desirable for both the Government and taxpayers in general that the further question of cost basis which is thus raised be decided now. We do not believe that the Court should in such circumstances apply a rule so harsh as to preclude consideration of a question which was anticipated at the earliest reasonable opportunity, passed on by the court below, and duly presented in the petition, especially where consideration of the question did not and cannot result in prejudice to the taxpayer's defense.

[18] The decision of the Board, entered pursuant to rule 50, was to the effect that there is a deficiency of $5,831.67 in the respondent's income tax for the year 1929 (R. 45). Had the transaction been taxed as a capital gain the deficiency would have been somewhat less.

III

IF THIS COURT SHOULD DECIDE POINTS I AND II ADVERSELY TO THE GOVERNMENT, THE CASE SHOULD BE REMANDED TO THE BOARD OF TAX APPEALS TO DETERMINE THE APPLICATION OF SECTION 115 (g) TO THE CIRCUMSTANCES OF THIS CASE

In this case the corporation redeemed the preferred stock three months after it had been issued, and during the same taxable year (R. 33). If this Court should decide against the petitioner on both of the preceding points, we submit that the case should be remanded to the Board of Tax Appeals to determine whether the redemption of the preferred stock was made at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928, *infra*, p. 38.

At the original hearing before a division of the Board of Tax Appeals the sole question was whether the redemption of the preferred stock, previously declared as a dividend in the same taxable year, was essentially equivalent to the distribution of taxable dividend under Section 115 (g) of the Revenue Act of 1928 (R. 14). While the division, consisting of a single member, had the case under consideration, the Board decided *Tillotson Manufacturing Co.* v. *Commissioner, supra,* in which it held that a dividend upon preferred shares payable in common was not a tax-free stock dividend under Section 201 (f) of the Revenue Act of 1926,

and that the cost basis of the preferred shares could not be reduced on account of the dividend. After an adverse decision by the Division, the Commissioner filed a motion for reconsideration in the instant case because of the *Tillotson* decision (R. 22–25). The motion was denied by the Division (R. 25) but on review by the Board this order was vacated and reconsideration of the original memorandum opinion was granted (R. 28). The case was assigned to another division and subsequently reviewed by the Board, which held (two members dissenting) that the stock dividend in question was subject to tax at the time of its receipt under Section 115 (f) of the Revenue Act of 1928 (R. 35), and that accordingly it was not necessary to pass upon the question whether the redemption of the stock previously declared as a dividend in the same taxable year was essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928 (R. 32).

The Board said (R. 32):

> If it be determined that the dividend was not a tax-free stock dividend when made on July 1, 1929, and therefore properly includable in income, that conclusion would be decisive here without passing upon the question of whether there was a redemption within the meaning of Section 115 (g) of the 1928 Act.

Section 601 of the Revenue Act of 1928, *infra*, p. 39, provides in part that the report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board. Inasmuch as the report was expressly ordered by the entire Board to be reconsidered (R. 28, 31), it is our understanding that the report of the division has no subsequent legal effect whatsoever. Nevertheless the lower court said in its opinion that the majority of the Board did not overrule the conclusion reached June 29, 1933, in which it was held that the preferred shares had not been redeemed in such manner as to make the transaction essentially equivalent to a taxable dividend (R. 57), and failed to remand the case for a decision by the Board on the point. We submit in view of the express order and opinion of the Board, that this was error. A decision which has been ordered to be reconsidered cannot be said to be the decision of the Board.

CONCLUSION

The lower court erroneously construed the term "stock dividend" in subdivision (f) of Section 115 of the Revenue Act of 1928 to include any stock dividend, whether it represented income under the Constitution or not. If, however, this Court should decide that the stock dividend was not taxable at the time of receipt, the cost basis of the dividend stock is zero. If this Court decides against the petitioner on both of these grounds, the

case should be remanded to the Board of Tax Appeals to pass upon the application of Section 115 (g).

Respectfully submitted.

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OCTOBER 1937.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * *

(2) Gift After December 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such prop-

erty as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) Transfer in Trust After December 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made;

(4) Gift Or Transfer In Trust Before January 1, 1921.—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in section 402 (e) of the Revenue Act of 1921, or in section 302 (f) of the Revenue Act of 1924 or the Revenue Act of 1926 (relating to property passing under power of appointment) regardless of the time of acquisition;

(5) Property Transmitted At Death.—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time

of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death;

* * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if

the cancellation or redemption is made after January 1, 1926.

(h) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

SEC. 601. BOARD OF TAX APPEALS—PROCEDURE.

Sections 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

"SEC. 906. (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

"(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless

within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board.

* * * * *

Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. [redacted] 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

H. C. GOWRAN.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

THE GUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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Supreme Court of the United States

OCTOBER TERM, 1936.

No. 887.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

H. C. GOWRAN.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

In this brief the petitioner above named will be sometimes referred to as the Commissioner of Internal Revenue, or as the Commissioner, and the respondent, H. C. Gowran, will be sometimes referred to as the taxpayer.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 39) is reported in 32 B. T. A. 820. The opinion of the Circuit Court of Appeals (R. 75) is reported in 87 F. (2d) 125.

JURISDICTION.

The taxpayer concedes the jurisdiction invoked by the Commissioner.

QUESTIONS PRESENTED.

1. Whether a dividend by a corporation, paid in its own preferred stock to holders of common stock, produces alteration of the pre-existing proportionate interests of the stockholders of the corporation, so as to result in such stock dividend being income of the recipient under the Sixteenth Amendment to the Constitution.

2. Assuming that such a dividend does constitute income under the Sixteenth Amendment, was such income taxable to the recipient under Section 115 of the Revenue Act of 1928?

3. Assuming that such a dividend does not constitute taxable income of the recipient, what is the correct cost basis of the dividend stock, when the recipient later sells it?

4. In the event that it should be held that the stock dividend in question was not taxable income of the recipient at the date of its receipt and that the cost basis of the dividend stock is not zero, the further question is presented whether the case should be remanded to the Board of Tax Appeals for further consideration and discussion with respect to the application of Section 115(g) of the Revenue Act of 1928 (dealing with the redemption of stock under such circumstances that it must be treated as equivalent to the distribution of a taxable dividend).

STATUTES AND REGULATIONS INVOLVED.

These will be found in the appendix, *infra*, pp. 15-17.

STATEMENT.

The petition for writ of certiorari contains a statement of facts which, in the main, is sufficiently accurate for the purposes of this argument. The taxpayer's additions and amendments to the statement of facts are as follows:

1. The petition herein states that the original report of a division of the Board (in favor of the taxpayer, and holding that there was no deficiency), dated June 29, 1933, was afterwards reviewed by the entire Board, and it is argued that the report of the division was therefore never any part of the record in the case. This is error. The statute invoked (Section 601 of the Revenue Act of 1928, amending Section 906(b) of the Revenue Act of 1924, *infra,* pp. 16-17) provides that the report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board. But in this case the original report of the division, finding that there was no deficiency, became a part of the record because the chairman of the Board did not direct that the report should be reviewed by the Board. On the contrary, the Commissioner's motion for review by the Board was denied by the chairman of the Board on July 24, 1933 (R. 33).

2. Most of the facts were stipulated. The entire stipulation is found in the above mentioned memorandum opinion of June 29, 1933 (R. 19 to 25). All other necessary facts were proved without dispute. The distribution of the stock dividend, of which the taxpayer received a part on July 1, 1929, was substantially as set forth in the Commissioner's pending petition; but it should be added that the preferred stock that was distributed in this dividend was (a) non-voting under any circumstances, (b) limited to $100 per share in case of liquidation, and (c) limited to a

dividend of seven per cent per annum out of profits. The common stock held by the taxpayer, on which this dividend was paid, had full voting power, and unlimited participation in assets and earnings after satisfying the calls of the preferred stock.

3. The statement of facts in the petition refers to the theory that the value of the dividend shares, if the same did not constitute taxable income when received, was zero, so that on subsequent sale the price received constituted taxable income. Petitioner's statement says that the Circuit Court of Appeals rejected this theory, but the statement does not disclose the fact that the theory of a basis-of-zero was not mentioned in the Commissioner's notice of deficiency given to the taxpayer, nor in the pleadings filed by the parties with the Board of Tax Appeals, nor in the findings and decision of the Board, but was first presented as an alternative argument in the brief of the Commissioner filed with the Circuit Court of Appeals.

Argument.

1. The court below assumed that a stock dividend, paid in preferred shares to holders of common shares, produces an alteration of the pre-existing proportionate interests of the stockholders, so as to result in income under the Sixteenth Amendment to the Constitution. The taxpayer does not admit that income under the Constitution arises in this way, and points out that there is a difference between a dividend in preferred shares on common and a dividend in common shares on preferred. The former does not change voting power nor disturb any stockholders' equity, while the latter does both. However, the point will not be argued here for the reason that this taxpayer's stock dividend was not subject to income tax, whether it constituted income under the Constitution or not.

2. Assuming that such a dividend does constitute income under the Sixteenth Amendment, was such income taxable to the recipient under Section 115 of the Revenue Act of 1928? The Revenue Act last mentioned was in force at the time when this taxpayer received his stock dividend on July 1, 1929, and Section 115(f) provided that "a stock dividend shall not be subject to tax."

The Circuit Court of Appeals for the Seventh Circuit in the present case, and the Circuit Court of Appeals for the Second Circuit in the case of *Pfeiffer* v. *Commissioner*, 88 Fed. (2d) 3, both held that Section 115(f) meant what it said, and that a stock dividend was exempt whether paid in the same class of stock previously held by the stockholder or in a different class. The opinion in the Pfeiffer case states that it is very clear from the opinion of this court in the Koshland case (*Koshland* v. *Helvering*, 298 U. S. 441) that Congress had left untaxed certain types of stock dividends which under the Constitution might have been lawfully taxed as income; also that the Koshland case indicates clear recognition that the exemption contained in the Revenue Act, Section 115(f), was broader than required by the decision of *Eisner* v. *Macomber*, 252 U. S. 189, and that such exemption must be considered coextensive with that contained in the Regulations.

The Regulations of the Treasury Department in effect at the time of the stock dividend in the Pfeiffer case and also this present case, provided that all dividends paid to stockholders of a corporation in stock of the same corporation should be exempt from income tax. (Art. 628, Regulations 74, *infra*, p. 17.)

Section 115(f) of the Revenue Act of 1928 is clear and unambiguous. It says "a stock dividend shall not be subject to tax". There is no room here for construction, or for consideration of legislative histories or reports of con-

gressional committees. It has been repeatedly so held by this court.

Osaka Shosen Kaisha Line v. *United States,* 81 L. Ed. (Adv. Ops.) 338, 339.

Kuehner v. *Irving Trust Company,* 81 L. Ed. (Adv. Ops.) 248, 250.

3. Assuming that a stock dividend of the kind involved here does not constitute taxable income of the recipient, what is the correct cost basis of the dividend stock, when the recipient later sells it? The Commissioner argues on this application that the cost basis must be zero, and that when the taxpayer later sold the stock for $100 per share he realized a capital gain of that amount. This was an idea brought into the case long after it had been tried and disposed of by the Board of Tax Appeals, as indicated above in paragraph 3 of our statement of facts. The three theories of tax liability asserted by the Commissioner at different times during the course of this proceeding were:

(a) That the distribution of the stock dividend and its later repurchase by the company made the transaction essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115(g) of the Revenue Act of 1928. This was the basis of liability disclosed by the Commissioner's deficiency letter and by the pleadings before the Board of Tax Appeals, and was disposed of by the first decision of the Board, holding in favor of the taxpayer on that issue (R. 18-28).

(b) That the stock dividend was taxable when received as if it had been cash, in spite of Section 115(f) of the Revenue Act of 1928. This theory was presented at the second argument before the Board and sustained by the Board, but the Board's decision was reversed by the Circuit Court of Appeals (R. 75-78).

(c) That the dividend when received had a basis for income tax purposes of zero, so that when later sold it gave the taxpayer a capital gain of $100 per

share. This basis of liability was never presented at any time to the Board of Tax Appeals. It was first presented as an alternative argument in the brief of the Commissioner filed with the court below.

This third theory is now brought forward as an additional ground for granting certiorari in this case. A sufficient answer is that it involves an issue raised for the first time before the Circuit Court of Appeals and one which should therefore be disregarded altogether.

General Utilities and Operating Company v. *Helvering*, 296 U. S. 200, 206.

Helvering v. *Salvage*, 297 U. S. 106, 109.

In the General Utilities case, this court said:

> "The second ground of objection, although sustained by the Court, was not presented to, or ruled upon by, the Board. The petition for review relied wholly upon the first point, and in the circumstances we think the Court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

The "basis-of-zero" theory is not entitled to be considered, because it was not properly raised.

But if nevertheless the "basis-of-zero" theory be considered here, it will be found to have no merit. The Board of Tax Appeals found that the fair market value of the dividend stock, when received by the taxpayer on July 1, 1929, was $100 per share. That finding has not at any time been disputed by either the Commissioner or the taxpayer. The court below took $100 per share as fair market value at date of distribution. At this point in our argument it will be assumed that the particular stock dividend in question was income within the constitutional definition, but was exempt from tax under Section 115(f) of the Revenue Act of 1928. The taxpayer, therefore, had an acquisition

of property on July 1, 1929, to wit: stock valued at $100 per share; and when the taxpayer later sold this property for $100 per share, there was no capital gain and no taxable income. That was the decision of the court below in this case, and it was clearly correct.

If, for income tax purposes at date of acquisition, the dividend stock had a value of $100 per share, then the same stock a few months later had precisely the same value per share as a basis for computing capital gain or loss on sale. The stock could not be valued at $100 per share for income tax purposes on July 1, 1929, and valued at something less than that, or at nothing at all, when later sold. The fact that the Government did not collect any income tax on the dividend income of the taxpayer (whether because the law exempted the transaction from tax or because the taxpayer failed to report the income) does not change the rule. The value of the shares for income tax purposes when received by the taxpayer continues to be the value of the shares, as a basis for computing capital gain on later sale, as settled by the decisions of the Circuit Court of Appeals for the Second Circuit and of this court in the Salvage case.

Salvage v. *Commissioner*, 76 Fed. (2d) 112 (Mar. 18, 1935). Affirmed: *Helvering* v. *Salvage*, 297 U. S. 106 (Jan. 13, 1936).

In the Salvage case, the Circuit Court of Appeals found that the taxpayer received in 1922 certain shares of stock having a fair market value at that date of $230,622, and that under the circumstances of the case that amount was taxable as income of the taxpayer in that year; that by mistake and oversight the taxpayer did not report that income and the same went untaxed; and that when the taxpayer sold the same stock in 1929, the basis of the stock for determination of capital gain was fair market value at date of acquisition, or $230,622. That decision was affirmed by this court.

In this connection it may properly be asserted that in the absence of statutes providing otherwise, the income tax basis of property acquired otherwise than by purchase is the fair value of such property on date of acquisition. Note that the Revenue Act of 1918 contained no provision determining the basis of valuation of gift property, when later sold so as to realize gain or loss; but the Treasury Department itself (Treasury Regulations 45, Article 1562, *infra*, p. 17) fixed such basis as fair market value at date of acquisition. That basis was approved by the Treasury Department and the courts until a later Revenue Act specifically provided another basis. In the instant case there is in the Revenue Act no specific provision governing the cost basis of stock acquired by a tax-free stock dividend, so that the situation is precisely analogous with that which prevailed as to property acquired by gift prior to the Revenue Act of 1921.

The Commissioner has not cited any law, rule or regulation which requires or justifies cutting the basis of these shares (for income tax purposes when the shares were later sold) down to anything below the fair market value when acquired; and it simply cannot be done in the face of the decisions in the Salvage case.

If, however, it be assumed that the stock dividend in the present case was not income within the rule of the Koshland case, because of its having been paid in preferred stock to holders of common, then the apportionment of the cost between the old and new stock was properly made by the taxpayer under the Treasury Regulations in force at the time, and the taxpayer's profit on later sale of the preferred shares was properly computed, and the tax paid thereon, leaving no deficiency.

4. In this application the Commissioner asks that if (a) the stock dividend was not taxable income of the recipient

at date of receipt and (b) the cost basis of the dividend stock is not zero, the case should be remanded to the Board of Tax Appeals for further consideration and discussion with respect to the first theory of the Commissioner, viz: that the taxpayer's sale of the dividend shares resulted in taxable income under the provisions of Section 115 (g) of the Revenue Act of 1928 (dealing with the redemption of stock under such circumstances that it must be treated as equivalent to the distribution of a taxable dividend). (*Infra*, p. 16.)

This was the question presented by the Commissioner's deficiency letter, and was the question placed in issue by the pleadings before the Board of Tax Appeals, and was decided in favor of the taxpayer by a division of the Board (R. 18-28). As shown above, the Commissioner promptly filed his motion for a review of that decision by the whole board, and that motion was denied by the chairman on July 24, 1933 (R. 33). Thereupon the decision of the division, embodied in its memorandum opinion, became a part of the record, and became the report of the Board thirty days after the date of the report of the division. (Section 601 of the Revenue Act of 1928, amending Section 906 (b) of the Revenue Act of 1924, *infra*, pp. 16-17.) The later proceedings before the Board of Tax Appeals and before the Circuit Court of Appeals did not disturb the original opinion nor the grounds upon which it was based.

In its second opinion the Board clearly recognized that on the issue tried out before the Board, being the issue as to which the facts were stipulated, the taxpayer had been successful and was entitled to a finding of no deficiency; but the Board then went on to say (R. 40):

> "He (the commissioner) determined that preferred shares issued as a dividend on the common shares of the Hamilton Manufacturing Company on July 1, 1929, were redeemed by the company in such a manner as to make the distribution essentially equivalent

to the distribution of a taxable dividend under Section 115 (g) of the Revenue Act of 1928. The petitioners assigned error in such determination. The Board in its memorandum opinion heretofore entered considered the proceedings only upon the basis of such assigned error and determined *upon the facts* (emphasis supplied) that the preferred stock was not redeemed in 1929 in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend. The parties did not specifically raise, nor did the Board consider, the question of whether the dividend was tax-free or taxable to petitioners when the shares were issued on July 1, 1929. • • • (R. 41) If it be determined that the dividend was not a tax-free stock dividend when made on July 1, 1929, and therefore properly includable in income, that conclusion would be decisive here without passing upon the question of whether there was a redemption within the meaning of Section 115 (g) of the 1928 Act. There follow only those facts necessary to a determination of the one question now under consideration."

The second opinion of the Board says plainly that the Board had previously considered the proceedings upon the issue first raised, and had determined *upon the facts* that the preferred stock was not redeemed in 1929 in such manner as to bring the transaction within the provisions of Section 115 (g) of the Revenue Act of 1928; and the second opinion then goes on to a new decision which does not in any manner affect the finding and conclusion on the facts that had previously been made a matter of record. The second opinion clearly recognized the first decision in the taxpayer's favor and just as clearly left it standing without change.

Finally, the taxpayer points out that the finding in his favor on the first issue presented was on the facts and circumstances involved in this particular case, and does not

involve any question of public importance, and therefore furnishes no reason for granting certiorari.

Conclusion.

The application for a writ of certiorari in this case should be denied because:

1. There is here no conflict between decisions of circuit courts of appeals. On the contrary, two circuit courts of appeals have decided the main point in the same way.

2. The court below has not decided any important question of general law in a way probably in conflict with the weight of authority.

3. The court below has not decided any important question of Federal law which has not been (but should be) settled by this court. The decision that a stock dividend is not subject to income tax, under the provisions of the Revenue Act of 1928, is so obviously right that further consideration by this court is uncalled for. The taxpayer has urged that the question of a zero basis for the dividend shares, when later sold, should not be considered at all because not raised before the Board of Tax Appeals, but if it is to be considered, then the decision of the court below was right and no review is called for.

4. The claim of the Commissioner that a reason for granting certiorari is the large amount involved in similar pending cases is invalid. There is nothing in the record to support the Commissioner's assertion, and the taxpayer is without knowledge of the amounts involved in these other cases, or of the extent of the similarity; but it is urged that amounts involved in other similar cases do not warrant further review of a decision which, in this taxpayer's case, is so clearly correct.

5. The decision of the court below is not in conflict with applicable decisions of this court, nor has it departed from the usual course of judicial proceedings so as to call for an exercise of this court's power of supervision.

Respectfully submitted,

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Dated May 1, 1937.

APPENDIX.

STATUTES AND REGULATIONS INVOLVED.

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 115. Distributions by Corporations.

(a) Definition of dividend.—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) Source of distributions.—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning

of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * * *

(f) Stock dividends.—A stock dividend shall not be subject to tax.

(g) Redemption of stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) Definition of partial liquidation.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Sec. 601. Board of Tax Appeals—Procedure.

Sections 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

"Sec. 906. (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of

business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

"(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board.

* * * * * *

Treasury Regulations 74, relating to the Revenue Act of 1928:

Art. 628. Stock dividends.—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

Treasury Regulations 45, relating to the Act of 1918:

Art. 1562. In the case of property acquired by gift, bequest, devise or descent, the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition, or as of March 1, 1913, if acquired prior thereto. * * *"

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Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals in this case (R. 30) is reported in 32 B. T. A. 820. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 56) is reported in 87 Fed. (2d) 125.

JURISDICTION.

The statutory basis of the jurisdiction of this court is that which is asserted by petitioner. The judgment of the Circuit Court of Appeals (R. 60) was entered December 22,

1936. The Commissioner of Internal Revenue, petitioner in this court but respondent in the Circuit Court of Appeals, petitioned in due course for rehearing (R. 60), and the Circuit Court of Appeals denied that petition on January 12, 1937 (R. 60). The Commissioner then filed in this court his petition for certiorari, which petition was granted on May 17, 1937 (R. 61).

Questions Presented.

I. Whether a stock dividend, distributed by a corporation in its own preferred stock to holders of common stock, is subject to tax under Section 115(f) of the Revenue Act of 1928.

II. Whether such a stock dividend, paid in preferred stock on common, is income under the Sixteenth Amendment to the Constitution.

III. Assuming that such stock dividend does not constitute taxable income at the time of its receipt, what is the correct cost basis of the dividend stock,—its market value, or zero?

IV. Was the question of the correct cost basis of the dividend stock properly raised in the court below?

V. In the event that this court should hold that the stock dividend in question was not taxable at the time of its receipt and the cost basis of the dividend stock under the circumstances is not zero, the Government raises this further question: whether the case should be remanded to the Board of Tax Appeals for further hearing with respect to the application of Section 115(g), dealing with the redemption of stock under such circumstances that it should be treated as equivalent to the distribution of a taxable dividend.

Statutes and Regulations Involved.

The statutes and regulations involved in the instant case will be found in the Appendix, *infra*, pp. 47-51.

Statement of the Case.

The Commissioner asserted a deficiency in the Federal income tax of the respondent taxpayer for the year 1929. The taxpayer refused to admit such deficiency. The Commissioner's claim and the taxpayer's denial of it constitute the controversy involved in the case.

The statement of facts contained in the Commissioner's brief is incomplete, and in some respects is inaccurate. One thing in particular requires comment; the Commissioner's brief asserts that the first decision of the Board of Tax Appeals, in the form of the report of a division of the Board, was *reviewed* by the Board and therefore ceased to have any effect. The fact is that the division of the Board which conducted the hearing and heard the testimony made a report in favor of the respondent taxpayer, holding that there was no deficiency (R. 14-21); that the Commissioner moved for review by the Board under the provisions of Section 906(d) of the Revenue Act of 1924 as amended by Section 1000 of the Revenue Act of 1926 (R. 22); and that this motion for review was denied (R. 25). The issue as tried out before the Board of Tax Appeals, and thus disposed of, was the issue joined by the pleadings before the Board. A new and entirely different issue was raised by the Commissioner's motion for reconsideration. In urging reconsideration, the Commissioner did not challenge the correctness of the first decision in favor of the taxpayer, based as it was on the facts and circumstances proved without dispute at the hearing, but cited the Board's decision in *Tillotson Mfg. Co.* v. *Commissioner*, 27 B. T. A. 913, and urged that the rule of that case ought to be followed, and

that the result would be a deficiency against the taxpayer on a new theory of tax liability (R. 22-25). On reconsideration, the Board followed precisely the Commissioner's argument, held that the instant case was ruled by the *Tillotson* case, and adjudged a deficiency without changing or reviewing the original decision in favor of the taxpayer on the issue presented by the pleadings (R. 31-35).

For the purpose of correcting and supplementing the statement of facts in the Commissioner's brief, the respondent taxpayer states that the company which distributed the stock dividend in question, Hamilton Manufacturing Company, had in 1929 two classes of stock: common stock without par value and preferred stock with a par value of $100 per share (R. 9). The preferred stock was non-voting, even in the event of default in payment of its dividends, and carried a preferential annual dividend limited to seven per cent., payable only out of profits (R. 9-10). The common stock carried full voting rights, one vote per share, and was entitled to unlimited dividends after payment of all accrued dividends on preferred stock, and entitled also to all of the assets of the company on liquidation after payment of the par value of outstanding preferred stock (R. 9-10).

Prior to the distribution of the stock dividend on July 1, 1929, the company's issued preferred stock and issued common stock stood at the amounts stated in the Commissioner's brief, respondent taxpayer being then a holder of common stock but not of preferred (R. 11). The dividend was distributed on July 1, 1929, in the form of preferred shares to holders of common, and respondent taxpayer received in this way 533 shares of preferred stock (fractional shares omitted), being the proportionate amount of the dividend shares due him on account of his common shares previously owned (R. 13-33). While the case was pending before the Board of Tax Appeals, it was stipulated that the fair market value of these preferred shares, at the date of

the stock dividend, was the same as their par value, to-wit: $100 per share (R. 30).

A few months later the taxpayer sold his dividend shares back to the company at $100 per share (R. 31-33). This sale by the taxpayer to the company was the result of a special arrangement between the company and four of its thirty common stockholders, whereby the company purchased the dividend stock for resale to its employees (R. 19; R. 33). On the hearing before the Board, evidence was taken relative to this purchase of stock by the company, and the decision (R. 14-21) embodied findings as to the reasons and circumstances and the conclusion that there had been no redemption or cancellation of the taxpayer's dividend stock at a time and in the manner that would make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend under the provisions of Section 115(g) of the Revenue Act of 1928. In fact, the decision held that there had been no redemption or cancellation at all. Since there was no dispute as to the facts, the evidence was not printed in the record. A stipulation covering most of the facts was entered into at the Board hearing and is in the record (R. 8-13), and this, together with matters set forth in the several opinions promulgated by the Board, embody all the facts that it is necessary to have before the court for the determination of the points of law involved.

In making his return of 1929 income, the taxpayer reported $47,161.62 of capital net gain, which included $27,262.72 as capital net gain on the sale of his dividend shares (R. 6). The latter figure was computed under Treasury Regulations then in force (Articles 58 and 600, Regulations 74), by spreading the cost of the taxpayer's original shares between the total number of original and dividend shares held after the dividend, and from the cost basis of the dividend shares so obtained computing the profit per

share on a sale at $100. The Commissioner, by his deficiency letter, eliminated from gross income the $27,262.72 of capital net gain on the taxpayer's sale of dividend shares, but added back the entire par value of the dividend shares, $53,371.50 (R. 6-7). The sole ground asserted by the Commissioner for thus increasing the taxpayer's taxable income was that "the redemption of the stock by the corporation is essentially equivalent to the distribution of a taxable dividend", under the provisions of Section 115(g) of the Revenue Act of 1928 (Commissioner's deficiency letter, admitted by the pleadings to have been sent to the taxpayer; (R. 6 and 7).

The taxpayer in due course petitioned the Board of Tax Appeals for redetermination of the deficiency, the pleadings raising the single issue based on Section 115(g) of the 1928 Revenue Act. On that issue the decision went in favor of the taxpayer, as indicated above. Thereafter the Board granted reconsideration, and, with two members dissenting, made a decision which may be summarized as follows: the Commissioner determined that there had been a redemption of dividend shares in such a manner as to make the transaction essentially equivalent to the distribution of a taxable dividend under Section 115(g) of the Revenue Act of 1928; the taxpayer assigned error in such determination, and "the Board, in its memorandum opinion heretofore entered, considered the proceedings only on the basis of such assigned error and determined, upon the facts, that the preferred stock was not redeemed in 1929 in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend"; the parties did not raise nor did the Board consider the question of whether the dividend was tax-free when the shares were issued on July 1, 1929 (R. 31); in the *Tillotson* case the Board had held that the distribution of a stock dividend in common shares to holders of preferred resulted

in such a change of interest as to produce income (R. 33, 34); the rule of the *Tillotson* case must control the instant case, although the dividend here was in preferred shares on common (R. 34); and "the disputed dividend • • • of a fair market value of $1[illegible] per shares, when issued on July 1, 1929, was not a tax[illegible]ree stock dividend" (R. 35). It should be noted that this second decision of the Board stated that the Board (not merely a division of the Board) had determined, *upon the facts*, that the preferred stock was not redeemed in such a manner as to make the transaction equivalent to the distribution of a taxable dividend, but that nevertheless a deficiency judgment must go against the taxpayer under the rule of the *Tillotson* case.

The taxpayer appealed to the Circuit Court of Appeals for the Seventh Circuit. There counsel for the Government argued that the fair market value of the stock received by the respondent taxpayer on July 1, 1929, was taxable income of the respondent and other stockholders notwithstanding Section 115(f) of the 1928 Act which declared that a stock dividend was not subject to tax. The Government then urged upon the court this further contention, by way of an alternative argument: if the stock in question was not taxable as a dividend at the time of its receipt, it was taxable at the time it was sold three months later, the income resulting from the sale being measured by the difference between a cost basis of zero and a sale price of $100 per share. This claim of the Commissioner had not been mentioned in his deficiency letter nor in his answer filed with the Board of Tax Appeals, nor had it been urged by the Commissioner at any time before the Board nor brought up by cross-appeal to the court below.

The court below reversed the decision of the Board, and in its opinion stated that the Board, by its second decision (June 27, 1935) "did not overrule the conclusions reached

June 29, 1933, wherein it was held that the preferred shares had not been redeemed in such manner as to make the transaction essentially equivalent to a taxable dividend", but that the Board in its second decision had held that the original distribution was not a tax-free stock dividend (*Gowran* v. *Commissioner,* 87 Fed. (2d) 125, 126, 127). The court assumed that the stock dividend in question, paid in preferred shares to holders of common, was income within the definition of the Sixteenth Amendment, but held that it was not taxable income in view of the express provision of Section 115(f) of the 1928 Revenue Act, viz: that a stock dividend shall not be subject to tax. As to the Commissioner's second and alternative contention, viz: that the taxpayer's cost basis on the dividend shares was zero and that he realized taxable profit when the shares were later sold, the court did not decline to pass on the point because of its not having been raised before the Board (which was the ruling of the Circuit Court of Appeals for the Second Circuit in *Pfeiffer* v. *Commissioner,* 88 Fed. (2d) 3), but considered the point on the merits and rejected it. The court held that fair market value of the dividend shares at date of receipt by the taxpayer, viz: $100 per share, was the basis for computing gain or loss on later sale, and that since they were sold for $100 per share there was no taxable income.

SUMMARY OF ARGUMENT.

Point I.

All stock dividends are exempt from taxation under the provisions of Section 115(f) of the Revenue Act of 1928. That section reads: "A stock dividend is not subject to tax." Whether the stock dividend received by respondent was income under the Sixteenth Amendment, or was not income at all, the statute quoted made it nontaxable at the time it was received, July 1, 1929. The language of the statute is plain, and does not admit of any search for a legislative intent differing from the words used. Section 115(f) is in harmony with the other provisions of the Revenue Act of 1928. Congress having inserted the section, without change, in six successive revenue acts, beginning with 1921 and ending with 1934, it is a necessary conclusion that it was the intent of Congress to confirm the administrative interpretation of the law which was made by the Treasury Department continuously through all of those years, viz: that all stock dividends of every kind were free of tax.

Point II.

The stock dividend in the instant case, having been paid in non-voting preferred stock to a holder of voting common stock, was not income within the meaning of the Sixteenth Amendment, because the distribution of the dividend did not result in the proportional interest of the stockholder becoming essentially different from what it had been before the distribution. In the absence of any such change of proportional interest, the dividend received by respon-

dent was no more income than it would have been if it had been a dividend in common stock on common.

Point III.

If the court below had power to consider and pass upon the basis of the dividend stock (a point not raised before or decided by the Board of Tax Appeals), then the decision of the court below was correct, viz: such basis was the fair market value of the dividend stock at the time acquired by respondent. This was stipulated to be $100 per share. Since he later sold the stock at $100 per share, there was no resulting gain in the transaction. The cost basis of the dividend stock was not zero, as urged by the Government, but was fair market value as in the case of tax-free gifts and legacies.

Point IV.

The question of the correct cost basis of the dividend stock, in the event of sale thereof by the recipient, was not mentioned in the Commissioner's deficiency letter to the taxpayer nor in the pleadings before the Board of Tax Appeals; was not brought up before the Board of Tax Appeals by argument, motion or in any other way; and was therefore not within the reviewing power of the Circuit Court of Appeals. When counsel for the Government urged that the Circuit Court of Appeals consider the question, and find a basis of zero for the dividend stock, that court ought to have declined to consider the point.

Point V.

The Government's contention that this case should now be remanded to the Board of Tax Appeals, for a new hearing and new determination with respect to the application of Section 115(g) of the Revenue Act of 1928, should be overruled. That section provides that if a corporation cancels or redeems its stock under circumstances which make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount distributed in redemption or cancellation shall be treated as a taxable dividend. That was the issue originally presented in this case, and it was tried out before the Board of Tax Appeals and decided in favor of the taxpayer. The decision was in the form of the report of a division of the Board, and thirty days after the filing of this report it became the decision of the Board because review thereof was denied by the Board. The Commissioner has not at any time asserted error in the trial or determination of that issue. In deciding the issue on the evidence, the Board concluded that there had not been any redemption or cancellation of the dividend stock in a manner making the transaction equivalent to a taxable dividend, and that there had not been in fact any redemption or cancellation at all. No reason has been shown for a new trial of the factual issue.

ARGUMENT.

POINT I.

ALL STOCK DIVIDENDS ARE EXEMPT FROM TAXATION UNDER SECTION 115(F) OF THE REVENUE ACT OF 1928.

The language of the statute is so broad as to exempt from taxation all stock dividends, including those which do and those which do not constitute income to the shareholder. The language of the statute, Section 115(f) of the Revenue Act of 1928, is this: "A stock dividend is not subject to tax."

In its opinion in the *Koshland* case, this court said at page 445:

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921. Soon after the passage of that Act, this court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially diffeernt from his former interest. Nevertheless the successive statutes and Treasury Regulations respecting taxation of stock dividends remained unaltered."
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> *Koshland* v. *Helvering*, 298 U. S. 441, 445.

Thus it is clear that a dividend declared in common stock to holders of common is a stock dividend, but is not income of the stockholders; also that a dividend declared

in stock of one class to holders of stock of another class is a stock dividend, and is income if the distribution of the dividend results in an essential change in the proportional interest of the stockholder in the corporation. If the stock dividend is not income, it cannot be taxed under the Sixteenth Amendment. If the stock dividend is income, it cannot be taxed because it is "not subject to tax" under the statute.

This is the interpretation of the *Koshland* case that has been adopted by the Board of Tax Appeals. In the case of *August Horrman* (October 31, 1936) the Board said:

> "But whether we are right or wrong in our interpretation of the Koshland case and whether or not the preferred stock dividend of 1932 was income, we are of the opinion that it was not taxable to the stockholders. Of course, if it was a stock dividend within the compass of *Eisner* v. *Macomber* it was not income under the Sixteenth Amendment; if it was income as in the Koshland case, it was nevertheless a stock dividend which was specifically exempt from tax under Section 201(d) of the Revenue Act of 1921."
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> *August Horrman,* 34 B. T. A. 1178, citing *Eisner* v. *Macomber,* 252 U. S. 189.

The decision just cited came after the decisions of the Board in the case at bar and in the *Pfeiffer* case, and indicates that the Board finally conceded that its decisions were wrong in the two cases mentioned, and that *all* stock dividends must be deemed exempt from tax.

The Circuit Court of Appeals for the Second Circuit in the *Pfeiffer* case has indicated by its opinion that it also understands the Koshland decision to mean that all stock dividends are exempt from tax under the statute.

Pfeiffer v. *Commissioner,* 88 Fed. (2d) 3, 4.

There is nothing ambiguous about the term "stock dividend." When a corporation distributes fresh issues of its

own stock to its existing stockholders, it is a stock dividend.

14 C. J. 812.

7 Thompson on Corporations, 3rd Ed. (1927) p. 137.

2 Clark & Marshall, Private Corporations, Sec. 523 e, page 1601.

Gray v. *Hemenway,* 212 Mass. 239, 98 N. E. 789.

That the term "stock dividend" has this definite and well-understood meaning is shown by its repeated use in the successive Revenue Acts. Prior to the decision of this court in *Eisner* v. *Macomber,* 252 U. S. 189 (March 8, 1920), the law contained this definition:

> "* * * The term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, either in cash or in stock of the corporation, * * * which *stock dividend* shall be considered income to the amount of its cash value." (Emphasis supplied.)
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> Section (2) (a) of Revenue Act of 1916.

The statute quoted was examined by this court in *Eisner* v. *Macomber,* and it was held that Congress did not have the power, under the Sixteenth Amendment or otherwise, to tax without apportionment a stock dividend such as that received by the taxpayer Macomber, and that therefore the Revenue Act of 1916, insofar as it imposed a tax upon the stockholders because of such a dividend, was invalid. In that case it appeared that the outstanding stock of the declarant corporation was all common stock, and that the stock dividend was distributed in shares of the same kind of stock, the total amount of the distribution being taken out of the earned surplus of the corporation. Under these circumstances the conclusion was that the corporation had

parted with nothing, and the stockholders had received nothing, the interest or equity of each stockholder being the same after the dividend as it was before. The court said:

> "A stock dividend shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer."
>
> *Eisner* v. *Macomber*, 252 U. S. 189.

In the Revenue Act of 1921 the Congress, pursuant to its understanding of the meaning of the decision in the *Macomber* case, changed the law relative to stock dividends by providing that "a stock dividend shall not be subject to tax." This is the language of Section 201(d) of the 1921 Act, and it was re-enacted as Section 201(f) of the Revenue Acts of 1924 and 1926 and as Section 115(f) of the Revenue Acts of 1928, 1932 and 1934. There can be no possible doubt as to the meaning of the term "stock dividend" in view of the standard definitions and in view of its uniform and long-continued use by Congress. It should be noted that Congress again used the term in its standard sense in Section 115(f) of the Revenue Act of 1936, enacted after the decision of this court in the *Koshland* case (Act of June 22, 1936, c. 690, 49 Stat. 1648). By the 1936 Act a stock dividend which is income of the stockholder, within the meaning of the Sixteenth Amendment to the Constitution, is made subject to the income tax.

From *Gibbons* v. *Mahon* (1890) down to *Koshland* v. *Helvering* (1926) this court has used the phrase "stock dividend" in many decisions, and either expressly or by necessary implication has defined it as meaning what Congress and the Treasury Department have always assumed it meant, viz: the distribution by a corporation of fresh

issues of its own stock to its existing stockholders. A few of these decisions are:

Gibbons v. *Mahon,* 136 U. S. 549.
Towne v. *Eisner,* 245 U. S. 418, 424, 426.
Eisner v. *Macomber,* 252 U. S. 189, 199, 201.
Weiss v. *Stearn,* 265 U. S. 242, 253.
Koshland v. *Helvering,* 298 U. S. 441, 444, 445, 446.

It is a stock dividend whether the stock distributed is common stock to present holders of common or is preferred stock to present holders of common or is common stock to present holders of preferred. The term "stock dividend" is not limited by law to a distribution of stock of the same class or preference as that on which the dividend is paid. This was understood by the Treasury Department when it changed its regulations in 1920 so as to provide a method for allocating the cost of the original shares between such shares and the dividend shares for the purpose of determining gain or loss on sale of either, for these changes in the regulations included specific provisions for the handling of the problem "where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid." (Treasury Decision 3059, 3 C. B. 38). Thereafter for more than fifteen years the Treasury Department, by its regulations and decisions, continued to assert that a stock dividend included not only dividend shares of the same class as those previously held by the stockholder but dividend shares of a different class as well. That such is the view of this court is clear from the language used in the *Koshland* case on page 444:

> "After the decision the Treasury revoked regulations to the effect that a dividend paid in the corporation's stock is income and issued amended regulations, broadly phrased, that exempt all income *in the form of stock dividends, whether the dividend shares be of the same class as those theretofore held by the stockholder or of a different class.*" (Emphasis supplied.)

Thus we have a statute that says in plain and unambiguous language that "a stock dividend shall not be subject to tax." There are no words of qualification or limitation, so that "a stock dividend" must mean *any* stock dividend whether of common shares on common or of preferred shares on common, and whether constituting income under the Constitution or not constituting such income. There is no room here for construction or interpretation, and no occasion for an examination of the Congressional Committee Reports to ascertain what Congress meant by this enactment.

> "We are not at liberty to construe language so plain as to need no construction or to refer to Committee Reports where there can be no doubt of the meaning of the words used."
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> *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85.

> "It is elementary that where no ambiguity exists there is no room for construction".
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> *United States* v. *Missouri Pacific R. R. Co.*, 278 U. S. 269, 277.

> "The words being clear, they are decisive. There is nothing to construe. To search elsewhere for a meaning either beyond or short of that which they disclose is to invite the danger, in the one case, of converting what was meant to be open and precise into a concealed trap for the unsuspecting, or, in the other, of relieving from the grasp of the statute some whom the legislature definitely meant to include."
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> *Van Camp & Sons Co.* v. *American Can Co.*, 278 U. S. 245, 253.

Section 402 of the Revenue Act of 1918 was the statute passed upon by this court in *Crooks* v. *Harrelson* (1930). The statute subjected to an estate tax the real estate of a decedent only if such real estate was subject to (a) charges

against the estate, (b) expenses of administration, and (c) distribution as part of the estate. Under the law of Missouri, real estate of a decedent was not subject to expenses of administration. This court held that it was therefore necessary to exclude from the estate of the decedent all of his real estate. In answer to one of the arguments of counsel for the Government, this court said:

> "It is urged, however, that if the literal meaning of the statute be as indicated above, that meaning should be rejected as leading to absurd results, and a construction adopted in harmony with what is thought to be the spirit and purpose of the Act in order to give effect to the intent of Congress. The principle sought to be applied is that followed by this court in *Church of the Holy Trinity* v. *United States*, 143 U. S. 457; but a consideration of what is there said will disclose that the principle is to be applied to override the literal terms of a statute only under *rare and exceptional circumstances* (Emphasis supplied). The illustrative cases cited in the opinion demonstrate that to justify a departure from the letter of the law upon that ground, the absurdity must be so gross as to shock the general moral or common sense. Compare *Pirie* v. *Chicago Title & T. Co.*, 182 U. S. 438. And there must be something to make plain the intent of Congress that the letter of the statute is not to prevail. *Treat* v. *White*, 181 U. S. 264.
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> "• • • In support of the claim that a literal construction is not admissible it is said that by other provisions of Section 402 certain interests in real property, such as dower, etc., are made subject to the tax without regard to the conditions set forth in subdivision (a), and that this results in an incongruity amounting to an absurdity. But unless the constitution be violated, Congress may select the subjects of taxation and qualify them differently as it sees fit; and if it does so in plain terms, as it has done here, it is not within the province of the court to modify the law by construction. • • •
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> "Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter applies with peculiar strictness. In *United States*

v. *Merriam*, 263 U. S. 179, after saying that 'in statutes levying taxes a literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used', we quoted with approval the words of Lord Cairns in *Partington* v. *Atty. Gen.*, L. R. 4 H. L. 100, 122, that 'if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.'"

Crooks v. *Harrelson*, 282 U. S. 55, 59, 61.

In *Old Colony R. R. Co.* v. *Commissioner*, this court still further emphasized the necessity of ascribing to statutes, especially taxing statutes, the ordinary and plain meaning of the words used by the Legislature. This was a tax case also, and the Government contended that the word "interest", used in the sense of a return on loaned capital, must be given a special and restricted meaning in order to carry out the intent of the income tax law. The contention was rejected, this court holding that the legislature must be presumed to use words in their known and ordinary signification; that the plain meaning of a statute is always to be preferred to any narrow or hidden sense; and that this rule is applied to tax acts (citing *De Ganay* v. *Lederer*, 250 U. S. 376). The opinion goes farther, and says that if there were any doubt as to the meaning of the term, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer (citing *Gould* v. *Gould*, 245 U. S. 151; *United States* v. *Merriam*, 263 U. S. 179; *Bowers* v. *N. Y. & A. Lighterage Co.*, 273 U. S. 346; *United States* v. *Updike*, 281 U. S. 489; *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648).

Old Colony R. R. Co. v. *Commissioner*, 284 U. S. 552, 560, 561.

As pointed out by this court in the *Koshland* case, Congress supposed in 1921 that the *Macomber* decision meant

that no stock dividend could constitute income under the Sixteenth Amendment, and proceeded to amend the statute in accordance with this view. All stock dividends were made non-taxable, and were kept so by the Revenue Acts of 1924, 1926 and 1928. Whether or not Congress would have taxed that type of stock dividend which constitutes income, if Congress had known that such a type of stock dividend existed, is a matter of pure speculation. It has nothing to do with the rights or liabilities of this taxpayer in respect of the stock dividend which he received in 1929. The Government can hardly argue that Congress, unconsciously and without knowledge that it had constitutional power to do it, placed an income tax on certain kinds of stock dividend by the Act of 1921, or by the successive Acts of 1924, 1926 and 1928. The fact of the matter is quite evident: Congress learned after the announcement of the decision of this court in the *Koshland* case that there were certain types of stock dividend which constitutionally might have been subjected to tax, but which had not been subjected to tax, and then proceeded to remedy the situation by changing this portion of the law to the form now found in Section 115(f) of the Revenue Act of 1936. By that section Congress imposed a tax where none had previously existed.

The Government's argument suggests that Section 115(f) of the Revenue Act of 1928 cannot mean what it says for the reason that exempting stock dividends from tax is inconsistent with the rest of the statute. It is believed unnecessary to challenge this position by extended argument. Complete consistency in the law was accomplished by the Revenue Act of 1921, by granting an exemption to stock dividends and by modifying the general definition of the term "dividend" so as to eliminate from its scope any distribution made in "stock of the corporation". This brought all of the provisions of the statute into harmony, and there

was no further change in this respect until the enactment of the Revenue Act of 1936.

Counsel for the Government urge in their brief that when Congress wrote into the income tax law, in 1921, the language that continued there and became Section 115(f) of the Revenue Act of 1928, the intent of Congress must have been to exempt from tax only such stock dividends as were not "income" within the meaning of the Sixteenth Amendment; and that if such was the intent of Congress, the section should not be read literally. The best answer to this contention is that the repeated re-enactment by Congress of the provision exempting stock dividends, without changing its language in any way, clearly indicated that Congress had approved and continued to approve the executive construction of the statute.

Shortly after the decision of this court in the *Macomber* case, the Treasury Department issued Treasury Decision 3052, 3 C. B. 38 (August 4, 1920), whereby it assured Internal Revenue officers and taxpayers that all stock dividends were tax-free in consequence of the *Macomber* decision. A few days later the Treasury Department revised its regulations then in effect (Regulations 45, issued under the Revenue Act of 1918) by revoking Article 1545 and amending Article 1547, the result being a provision that "stock received as a dividend does not constitute taxable income to the stockholders". The change in the regulations thus accomplished included specific directions for ascertaining cost of original shares and of dividend shares, for the purpose of computing gain or loss on sale of either. Treasury Decision 3059, 3 C. B. 38.

Soon after issuing the Treasury Decision last referred to, the Treasury Department put out Office Decision 732 (3 C. B. 39), whereby more detailed directions were given as to the adjustment of cost of both classes of stock where preferred is issued as a dividend on common.

The Treasury Department still later issued O. D. 801, 4 C. B. 24, which stated: "A stock dividend paid in true preferred stock is exempt from tax the same as though the dividend were paid in common stock".

Thus it is clear that the Treasury understood the *Macomber* decision to mean that *all* stock dividends must be exempted from income tax under the Constitution, and Congress accepted the Treasury's interpretation of the decision when it wrote into the 1921 Revenue Act, as Section 201(d), the words which later constituted Section 115(f) of the Revenue Act of 1928, viz.: "A stock dividend shall not be subject to tax". That it was the intent of Congress to follow the interpretation of the Treasury Department is confirmed by the language of this court in the *Koshland* case:

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921." (p. 445 of opinion).

In this matter of the exemption of all stock dividends from tax, the Treasury Regulations and Decisions continued without material change until 1936; and during that period Congress repeatedly re-enacted the clause exempting stock dividends from tax, necessarily with full knowledge of the administrative interpretation of it. The same clause appeared in six successive Acts of Congress, without change.

Nearly thirty years ago this court stated unequivocally that "we have decided that the re-enactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction".

United States v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, 339.

This court has reiterated the rule in many later decisions, of which the following are cited:

National Lead Co. v. *United States,* 252 U. S. 140, 146, 147.

Brewster v. *Gage,* 280 U. S. 327, 337.

McCaughn v. *Hershey Chocolate Co.,* 283 U. S. 488, 492, 493.

Murphy Oil Co. v. *Burnet,* 287 U. S. 299, 302, 303.

Massachusetts Mutual L. Ins. Co. v. *United States,* 288 U. S. 269, 273.

United States v. *Dakota-Montana Oil Co.,* 288 U. S. 459, 466.

Old Mission Portland Cement Co. v. *Helvering,* 293 U. S. 289, 293, 294.

The language of the statute here under discussion is too plain to justify any search for a legislative intent differing from the words used. But if legislative intent must be ascertained, it is submitted that such intent was made manifest by including the same words in six successive revenue acts through a period of thirteen years, during which time the Government's administrative interpretation of the law remained unchanged. This conclusion is hardly affected by the remark of Representative Vinson of Kentucky, during the debate preceding the adoption of the 1936 Revenue Act, to the effect that the proposed plan of taxing stock dividends does not change the law. (Quoted by counsel for the Government on page 20 of their brief.) Even if Mr. Vinson represented the "intent of Congress" in 1936, he did not indicate the intent of Congress at the time of the enactment of the 1928 Revenue Act.

What Representative Vinson said, according to the matter quoted on page 20 of the Commissioner's brief, was that under the 1934 Act there was a provision that said *no stock dividend should be taxed,* and then he proceeded to explain

that, without departing from the law as handed down by the Supreme Court in the case of *Eisner* v. *Macomber* it was proposed to tax certain stock dividends. This interpretation of his meaning is supported by his statement of April 27, 1936, reported in the Congressional Record of that day, at page 6214:

> "Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill. There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of *Eisner* v. *Macomber.*"

Further, on April 28, 1936, there was a colloquy between Representative Vinson and Representative Treadway, found at page 6309 of the Congressional Record of that day. Mr. Treadway quoted the clause which had been a part of all of the Revenue Acts since 1921, viz.: "A stock dividend shall not be subject to tax", and said:

> "That is the existing law and has been the law most of the time since the *Eisner* v. *Macomber* decision. In the next tax bill after that decision that language was included. I understand the gentleman's explanation to be that the language of the Act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the *Eisner* v. *Macomber* decision.
>
> "Mr. Vinson of Kentucky: That is correct."

It is respectfully urged that the stock dividend was not subject to tax when received by respondent, in any aspect of the case; that if the stock dividend was income, the statute made it non-taxable, and if it was not income it could not be taxed under the Sixteenth Amendment; and that the meaning of the statute, Section 115(f) of the Revenue Act of 1928, is clear, unambiguous, in harmony with the rest of the Revenue Act and obviously expresses the actual intent of Congress.

Point II.

THE STOCK DIVIDEND IN THIS CASE, PAID BY THE COMPANY IN ITS OWN PREFERRED STOCK TO HOLDERS OF COMMON, DID NOT CONSTITUTE INCOME OF THE RESPONDENT UNDER THE SIXTEENTH AMENDMENT.

It may not be necessary for this court to pass on this Point II. If it is decided that the stock dividend when received by respondent was not subject to tax under the Revenue Act of 1928, and that the question of the cost basis of the dividend shares sold by the taxpayer was correctly decided by the court below (or was not properly before that court for decision), the judgment of the court below will be affirmed regardless of the question of income under the Sixteenth Amendment.

However, counsel for the Government argue that respondent taxpayer received income at the time the dividend stock was delivered to him, even though the dividend in question was in the form of preferred shares delivered to a holder of common, which was the converse of the situation disclosed in the *Tillotson* and *Koshland* cases. In both of those cases, the dividend was paid in common shares to persons holding preferred:

Tillotson Mfg. Co. v. *Commissioner,* 76 Fed. (2d) 189.

Koshland v. *Helvering,* 298 U. S. 441.

Respondent submits the following in support of his contention that in the instant case the stock dividend did not constitute income under the Amendment.

This court has definitely held, by its decisions in the *Macomber* and *Koshland* cases, that a dividend paid in common shares on common does not constitute income under the Sixteenth Amendment, and that a dividend paid

in common shares on preferred does constitute income under the Sixteenth Amendment. The reason why a dividend of common on preferred results in income is that it produces a change in the proportional interests of the recipient stockholder.

If a dividend paid in preferred shares to holders of common, under the circumstances disclosed by the record here, did not result in the proportional interest of the stockholder becoming *essentially* different from what it had been before the distribution, then the stockholder received no income. In the absence of a change in proportional interest, a stock dividend paid in preferred on common is precisely the same thing as a stock dividend paid in common on common.

It has been shown that the preferred stock of the company carried a preferential dividend limited to seven per cent. per annum, payable out of profits only; that there was no provision in the company's articles of incorporation requiring any of the earned surplus to be reserved for payment of dividends on preferred stock; that preferred stock had no voting power under any circumstances; that on liquidation of the company, preferred stock would be paid off preferentially up to but not exceeding its par value of $100 per share; that the common stock carried all of the voting power, was entitled to receive unlimited dividends out of profits after payment of dividends on preferred, and was entitled to receive all of the net assets of the company on liquidation after payment of par to the preferred. Fair market value of the dividend stock when received by respondent was $100 per share.

Did the distribution of preferred stock to the respondent taxpayer, by way of dividend, result in his proportional interest becoming *essentially* different from what it had been before? Upon the facts established in the instant case, the answer would appear to be in the negative.

The dividend did not change voting power in the corporation. Since no part of the earned surplus was reserved for the benefit of preferred stockholders, the entire earned surplus was part of the stock equity of the common stockholders; and when the taxpayer received from the company a stock dividend valued at $53,300, his equitable interest in the earned surplus diminished by precisely that amount. The distribution of this stock dividend did not exhaust the earned surplus. A liquidation of the corporation immediately following the distribution of this stock dividend would have paid out to the taxpayer precisely the same amount that he would have received if there had been no such dividend. In other words, after the receipt of this dividend in preferred stock, the taxpayer's equity in the corporation,—his "proportional interest"—was not essentially different from what it had been before.

It must also be remembered that the dividend did not take from Hamilton Manufacturing Company any of its assets, nor did it increase any of its liabilities. It is submitted that since (a) the company parted with nothing, and (b) the stockholder received no net increase in his interest in the company, there was actually no income to the stockholder.

In the *Koshland* case, the stockholder, holding non-voting preferred stock, received in the dividend certain shares of voting common stock. This worked a distinct change in the stockholder's proportional interest in the company. She not only acquired voting power, which previously she had not had, but she acquired a block of stock carved out of the company's earned surplus, in which earned surplus she had not previously had any right or interest.

In the instant case, the stockholder receiving the stock dividend was no richer after he had received it than he was before. In the *Koshland* case the stockholder was richer

after the dividend, the amount of her enrichment being measured by the fair market value of the common shares received.

The Board of Tax Appeals decided the *Frances Elliott Clark* case after it had decided the *Tillotson* case. Here the dividend was declared on common stock but paid in preferred. It was urged before the Board that the *Tillotson* case was authority for holding that this distribution of preferred stock was taxable income of the stockholder. The Board held to the contrary, pointing out that in the *Tillotson* case there was a distribution of common stock in payment of a dividend on preferred, and that such a distribution was not a proportional redistribution of existing rights. In the *Clark* case it was the Commissioner who argued that the *Tillotson* case should not control, and the Board sustained the Commissioner's position and held that when the corporation distributed a dividend in its preferred stock, declared and paid on its outstanding common, "petitioner received thereby a stock dividend, which neither constitutionally (*Eisner* v. *Macomber*, 252 U. S. 189), nor by statute (Section 201(f) of the Revenue Act of 1926), is subject to income tax". This decision of the Board was affirmed by the Circuit Court of Appeals for the Third Circuit, without discussion of the constitutional question of income.

Clark v. *Commissioner*, 28 B. T. A. 1225, 77 Fed. (2d) 89.

In making its second decision in the instant case, whereby the Board held respondent liable for a deficiency, the Board did not follow its conclusions as set forth in the *Clark* case, which involved a dividend paid in preferred stock on common, but went back to the *Tillotson* case, which related to a dividend in common on preferred; and the Board decided that the preferred stock dividend received by respondent

changed his interest in the corporation in substantially the same manner as in the case of the stockholder receiving a stock dividend in common stock paid on preferred. The Board therefore held that respondent had received income, and also that it was taxable. The court below in this case, and the Circuit Court of Appeals for the Second Circuit in the *Pfeiffer* case, both assumed without discussion that a stock dividend in preferred stock on common stock is income, as is a dividend in common stock on preferred stock. In both cases, however, it was unnecessary for the courts to rule on this question, since they both held that the dividend was tax-free under the statute in any case.

No other decided cases, so far as we have been able to discover, have touched on the question. We have set forth above the reason why respondent feels that in this instance, at least, his proportional interest in the corporation was not essentially different after he received the stock dividend from what it had been before. If he is right in that, then he did not receive income, and his case is ruled by the decision of this court in *Eisner* v. *Macomber*. The result would be a judgment of no deficiency.

Before leaving this point it should be noted that counsel for the Government in their brief appear to lay emphasis on the fact that at the time the stock dividend in question was received by respondent, in the form of preferred shares, other preferred shares of the company were already outstanding in the hands of persons other than respondent. It is difficult to understand why this situation has anything to do with the question of income of the respondent. Under the circumstances of this case, the stock equity or "proportional interest" of the *stockholder receiving the dividend* remained the same, as has been shown, even though other persons held preferred stock before the dividend.

It may be argued that if the company later suffered important losses, sufficient to wipe out its earned surplus and the equity of its common stockholders and a part of the equity of its preferred stockholders, a liquidation of the company would pay something more to the stockholder who retained the preferred shares received in the dividend than he would be able to realize if he had not received them; but it is submitted that the test of income at the time the dividend shares are received must be a change of interest occurring *at that time,* and not an alteration of stock equities that may or may not occur at some time in the remote future.

There appears further to be an insuperable difficulty in *measuring* respondent's income, if his dividend of preferred stock on common is to be considered income. It has been seen that where the stock classifications are substantially the same as in this case, the holder of preferred stock who receives common stock in a dividend is enriched because his new stock comes out of a surplus in which he previously had no share or interest; and the measure of his enrichment is the fair market value of the common stock received. But the holder of common stock who receives preferred stock in a dividend is not enriched at all. The value of the new stock received is exactly balanced by the shrinkage of his share of the corporate surplus; and, further, the fair market value of the preferred stock which he receives in the dividend cannot possibly measure his income, even if income is present because of a change in his proportional interest in the corporation. This change in proportional interest, if an advantage to the stockholder at all, would not be an advantage measured by the fair market value of the shares received. Compare *Towne* v. *Eisner,* 245 U. S. 418, 426.

Point III.

THE COST-BASIS, SO CALLED, OF THE STOCK DIVIDEND IN THIS CASE WAS THE FAIR MARKET VALUE OF THE STOCK WHEN RECEIVED BY THE TAXPAYER.

In his briefs and argument before the Circuit Court of Appeals, the Commissioner set up as an alternative ground of tax liability a new theory which had not until then been considered or even mentioned at any time in these proceedings. This new theory will be referred to here as the "basis-of-zero" theory.

As has been shown in this brief (see "Statement of the Case", page 3, *et seq*), the Commissioner first asserted a deficiency against the respondent taxpayer on the ground that the latter had sold his dividend stock back to the company under such circumstances as to result in taxable income under Section 115(g) of the Revenue Act of 1928. The decision of the Board was against the Commissioner on this point, and there has been no appeal from it. The Commissioner next advanced the contention that when the taxpayer received the dividend stock of July 1, 1929, he then and there received taxable income because the dividend stock was of a different class from that which the taxpayer had previously held. On this theory, the Board of Tax Appeals sustained the Commissioner, but was reversed by the Circuit Court of Appeals. The third, or "basis-of-zero" theory, was first advanced by the Commissioner when the case was argued in the Circuit Court of Appeals. The taxpayer urged in that court that this new basis-of-zero theory could not properly be passed upon by the court, because it was a contention not made by the Commissioner's deficiency letter nor referred to in the

pleadings filed with the Board of Tax Appeals nor brought up in any way by argument or brief before the Board, nor brought into the Circuit Court of Appeals by cross-appeal or otherwise. The Circuit Court of Appeals nevertheless did consider and pass upon the basis-of-zero theory, but decided against the Commissioner on the merits, holding that the cost basis of the dividend shares when sold was their fair market value at the time they were received by the taxpayer, or $100 per share, and that when later sold at $100 per share there was no gain.

The taxpayer contends in this court that the Circuit Court of Appeals was correct in its decision on the merits, if that court was entitled to pass upon the basis-of-zero theory at all, and discussion of the merits follows. Under Point IV of this brief respondent will argue the question of whether the basis-of-zero theory was ever properly before the court below for decision.

It will no doubt be conceded that if the dividend shares when received by the taxpayer were not free of tax, they would have been valued at their fair market price for the purpose of computing the tax thereon. Apparently the Commissioner contends that the so-called cost basis of the dividend shares would have been fair market value if they were subject to tax, but must be considered zero if not subject to tax. It is difficult to justify such an argument.

Section 113 of the Revenue Act of 1928 provided that the basis of determining gain or loss from the sale or other disposition of property is the "cost" of the property. Where property is acquired by purchase the term "cost" is synonymous with the term "purchase price"; but this court has expressly held that where property does not have a "cost" in the conventional sense and the Revenue Act does not prescribe otherwise, the basis of the property is the fair market value at date of acquisition by the taxpayer.

In *Hartley* v. *Commissioner*, 295 U. S. 216, the court said at pp. 218-219:

> "The Court of Claims held that the time of acquisition, indicated by Sec. 202(a) of the 1921 Act and Sec. 204(a) of the 1924 and 1926 Act as the controlling date for calculating gain or loss to the estate in the course of administration, must be taken to be the date of acquisition by the decedent rather than the time of acquisition by the executor or administrator on the decedent's death. This conclusion, it was thought, was compelled by the statutory command that the basis of computation shall be 'cost', which could have no application to the acquisition by the executor or administrator, who is not a purchaser of the estate which he administers. *McKinney* v. *United States, supra* (62 Ct. Cl. 188). But this specification is not enough to restrict the effect of the general provisions of these revenue acts which impose a tax on the income, including capital gains, of taxpayers. *The use of the word cost does not preclude the computation and assessment of the taxable gains on the basis of the value of property, rather than its cost, where there is no purchase by the taxpayer, and thus no cost at the controlling date.* See *Heiner* v. *Tindle*, 276 U. S. 582, 585, 586, 72 L. ed. 714, 716, 717, 48 S. Ct. 326; *Lucas* v. *Alexander*, 279 U. S. 573, 578, 579, 73 L. ed. 851, 854, 855, 49 S. Ct. 426, 61 A. L. R. 906." (Emphasis supplied.)

The rule is, as indicated in the above quotation, that the basis of property acquired otherwise than by purchase is its fair market value when acquired, unless there is an express statutory provision prescribing some basis other than "cost". The principle has been consistently recognized by the Commissioner, the Board of Tax Appeals and the courts, in a variety of situations and irrespective of whether the acquisition of the property resulted in taxable income.

Note the Commissioner's application of the principle in the regulations (relating to the Revenue Act of 1918) which

pertain to property acquired by gift, bequest, devise or descent. The 1918 Act established the basis of property, when sold or otherwise disposed of, as its "cost", and contained no other provision that could be applied to property acquired otherwise than by purchase, such as gifts or bequests. The article of the regulations just referred to say that in the case of property acquired by gift, bequest, devise or descent, the basis for computing gain or loss on a sale of the property is its fair market value at date of acquisition. (Article 1562, Regulations 45.)

Under the Revenue Act of 1921, "cost" was the basis prescribed for computing gain or loss on later sale. In a case where a trustee had acquired property by a transfer in trust, not having paid anything for it, the Board of Tax Appeals said:

> "* * * The Act fails to specifically prescribe a cost basis to the trustee for the stock acquired by it as aforesaid. That being so, the cost basis to the trustee is the value of the property at the time acquired. (*Francis Francis* v. *Commissioner,* 15 B. T. A. 1332; *Rice* v. *Eisner,* 16 Fed. (2d) 358)".
>
> *Bankers Trust Co. v. Commissioner,* 24 B. T. A. 10.

To the same effect see:

Francis Francis v. *Commissioner,* 15 B. T. A. 1332.
Ward v. *Commissioner,* 29 B. T. A. 1251.

The principle that the fair market value of the property at date of acquisition must be used as its cost basis, when acquired otherwise than by purchase, is supported by the decision of the Circuit Court of Appeals for the Fifth Circuit in a case where land was acquired by gift. The Revenue Act of 1921 was the applicable statute. It prescribed no basis other than "cost" for the allowance of depletion on property so acquired. The court said:

> "We think the Board (of Tax Appeals) was correct in adopting the fair market value as the price or cost

of property acquired in that manner. Cost does not always mean the price paid for a thing."

Lucas v. *Daniel,* 45 Fed. (2d) 58, 60.

The same rule was applied by the Circuit Court of Appeals for the Seventh Circuit in the instant case. In overruling the Commissioner's contention that the basis of the dividend stock was zero, the court said:

"We liken the receipt of the tax-free income in the present case to that of a tax-free gift, bequest, legacy or other tax-free addition to the taxpayer's estate. One who receives a tax-free gift and later sells it, in the absence of statute providing otherwise, is taxed upon the profit arising from the difference in its value at the time he receives it and the sale price. Similarly one who receives a tax-free bequest, when selling it, is taxed upon the profit arising from any excess of the sale price over its fair market value at the time of receipt. The measure of liability of the taxpayer here is to be determined by the same standard; his tax, in case of sale, is to be computed just as if the dividend had not been tax-free. He must account for any difference between the stipulated value of $100.00 and the selling price. If this property were added to his estate by inheritance, and if there were no laws taxing it, upon sale of the same, under the established policy of the revenue laws of the United States, a tax would be assessed upon any profit resulting from a sale in excess of its value at the time he received it. The same yardstick must apply here."

Gowran v. *Commissioner,* 87 Fed. (2d) 125, 128.

This court's view of fair market value as a basis is well illustrated by the language of the decision in *Heiner* v. *Tindle,* a case which arose under the Revenue Act of 1918. The opinion there refers also to property acquired by gift, bequest or devise, and goes on to say:

"But it is pointed out that sec. 202 of the Revenue Act of 1918, prescribing the method of computing gain or loss upon the sale of property, makes value as of

March 1, 1913, or cost if acquired later, the basis of the computation * * *

"But it is obvious that sec. 202 is not all inclusive. The same and no greater inconsistency and difficulty arise in the case of property acquired by gift, bequest or devise, when *market value at the time of acquisition by the donee and not cost* is necessarily the basis of computing the tax. That in such cases the difference between the sale price and market value at the date of acquisition, if after March 1, 1913, is deductible under subsection (a) (5), is not questioned." (Emphasis supplied.)

Heiner v. *Tindle*, 276 U. S. 582, 585, 586.

The recent decision of this court in the *Koshland* case is not in conflict with the foregoing. In the *Koshland* case the taxpayer acquired certain shares of preferred stock by *purchase*, and later sold them. It was held that the purchase price was the cost, and that the cost was the basis for determining gain or loss on subsequent sale, as prescribed by Section 113 of the 1928 Revenue Act. In the *Koshland* case, none of the dividend stock had been sold, and accordingly the court did not pass on the basis of the dividend stock at all.

On page 27 of the Government's brief there is an argument to the effect that the analogy between tax-free gifts and devises on the one hand and stock dividends on the other does not exist, since "the reason for adopting the value at the time of acquisition as the basis for gifts and legacies is not present here". It is said that the value of a gift is subject to a gift tax and the value of a legacy is subject to an estate tax. But the analogy is perfectly good when made in respect of a stock dividend received by the taxpaper on July 1, 1929, for at that time there was no gift tax at all, and an estate of $100,000 or less could have been received by the taxpayer as a legacy or bequest free of estate tax.

If the stock dividend was not income, the *Koshland* decision does not apply; the dividend stock was an accretion of capital; the applicable regulations (Regulations 74, Articles 58 and 600) were valid; and petitioner correctly apportioned the cost of the dividend shares and correctly computed his taxable profit when he sold them.

If the stock dividend was income, but not taxable under Section 115 of the Revenue Act of 1928, the Government's basis-of-zero argument brings us to a curious and wholly illogical result, viz: *two* incomes growing out of the acquisition and sale of the dividend stock. Receipt of a hundred-dollar share of dividend stock would mean dividend income of $100 per share, tax free by statute, and the later sale of the same share would mean a capital-gain income of $100 per share, subject to tax. The difficulty disappears at once if we adopt the view of the court below.

Since in the case at bar the fair market value of the dividend stock was $100 per share when acquired, and since the taxpayer later sold the stock for $100 per share, there was no resulting gain to the taxpayer. The conclusion of the Circuit Court of Appeals on this point was correct.

Point IV.

THE QUESTION OF THE CORRECT COST BASIS OF THE DIVIDEND STOCK WAS NOT PROPERLY RAISED IN THE COURT BELOW.

The Commissioner's three separate theories of tax liability, asserted at different times since the inception of this proceeding in 1931, have been described at the beginning of the discussion under Point III of this brief. The first and original theory, if upheld, would have meant the receipt of *dividend* income by respondent in the sum of $100 per share on October 1, 1929, when he sold the dividend stock at

that price; the second, if upheld, would have meant the receipt of *dividend* income by the respondent in the sum of $100 per share on July 1, 1929, when he received the dividend stock; while the third, if upheld, would have meant a *capital gain* to the respondent, taxable at a different rate and under different regulations from those applicable to dividend income.

We believe the law is well settled that neither party to a tax proceeding of this kind is entitled to have the Circuit Court of Appeals or the Supreme Court pass upon a contention which was never made before the Board of Tax Appeals, was never mentioned in any pleading, argument or brief before that Board, nor in the Commissioner's notice of deficiency to the taxpayer, nor in any cross-appeal from the Board; and it would seem that the rules of law now so well settled in this conection must be fortified, in the instant case, by the fact that the Commissioner's third and final theory of tax liability would change the income which it is proposed to assess from dividend income to income by way of capital net gain.

In *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200, 206, this Court ruled in an identical situation:

> "The second ground of objection, although sustained by the Court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the Court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

Helvering v. *Salvage*, 297 U. S. 106, 109, is to the same effect. There this Court held:

> "The defense of estoppel was not before the Board. Under what we regard as the correct practice, *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, the court should have passed the point."

The rule announced in the two foregoing cases has been followed in *Pfeiffer* v. *Commissioner*, 88 Fed. (2d) 3; *Sunset Scavenger Co.* v. *Commissioner*, 84 Fed. (2d) 453; and *Helvering* v. *Montana Life Insurance Company*, 84 Fed. (2d) 623. In the *Pfeiffer* case, the Circuit Court of Appeals for the Second Circuit said:

> "The question of taxability as capital gain of the $200,000, or any part thereof, was not in issue before or decided by the Board of Tax Appeals. The contention that we have authority to sustain the deficiency *pro tanto* even though the issue was not raised before the Board nor decided by it, nor assigned as error in the petition to this Court for a review of the Board's decision is untenable. (Citing *General Utilities & Operating Co.* v. *Helvering, supra,* and *Helvering* v. *Salvage, supra*)".

In the *Sunset Scavenger Co.* case, the Circuit Court of Appeals for the Ninth Circuit said, referring to a point raised for the first time before the Circuit Court of Appeals:

> "However novel this argument may be, the opinion of the Board does not disclose that the argument was ever presented to it. * * * Under such circumstances, we cannot consider the point. (Citing *General Utilities & Operating Co.* v. *Helvering, supra,* and *Helvering* v. *Salvage, supra*)".

In the *Montana Life Insurance Company* case, the Circuit Court of Appeals for the Ninth Circuit said:

> "The powers of this court are appellate in nature to review errors committed by the Board of Tax Appeals. It being conceded in this case that the Board of Tax Appeals has committed error, we are required to reverse that decision. We find no occasion to enter into a discussion of questions which were not decided by the Board of Tax Appeals, and we have no power to decide such questions * * * (Citing *General Utilities & Operating Co.* v. *Helvering, supra.*)"

All of the cases last cited were tax cases. All of them passed upon and decided the question of whether a claim

of tax liability "not in issue before or decided by the Board of Tax Appeals," might properly be considered and decided by the Circuit Court of Appeals. All of them ruled the question in the negative. Respondent urges that the Government should not have been permitted by the court below to argue its basis-of-zero theory at all, because it raised an issue not pleaded, tried, argued or otherwise referred to in the proceedings before the Board.

In their argument *contra,* counsel for the Government cite *United States* v. *American Railway Express Co.,* 265 U. S. 425, *Langnes* v. *Green,* 282 U. S. 531, and *Stelos Co.* v. *Hosiery Corp.,* 295 U. S. 237. None of these cases is a tax case. None has anything to do with the nature or scope of the review by a Circuit Court of Appeals in cases brought there, by the statutory process, from the Board of Tax Appeals. The *American Railway Express Co.* case reached this court by direct appeal from the District Court for the Northern District of Georgia, three judges sitting; and the claim, consideration of which by this court was opposed by the Express Company, had been "adequately presented in the bill of complaint." That situation was nothing like that of respondent taxpayer in the court below, when in that court he pointed out that the new issue had not been pleaded nor even mentioned in the proceedings before the Board. *Langnes* v. *Green* was an admiralty case, involving proceedings to limit liability of a vessel owner. This court held that a contention made by respondent in the court below, and there overruled, might be urged in this court in support of the judgment in respondent's favor below, without his having filed a cross appeal. All of the matters there involved had been pleaded in and decided by the trial court (the district court). *Stelos Co.* v. *Hosiery Corp.* was a patent case. This court held that the defendants might have urged the point as to in-

validity, decided against them by the Circuit Court of Appeals, for the purpose of sustaining the judgment of that court, without applying for a cross-writ of certiorari; but here also the point at issue had been pleaded and argued both in the district court and the Circuit Court of Appeals. The three cases just discussed are not in point.

But *Stelos Co.* v. *Hosiery Corp.* and *United States* v. *American Railway Express Co.* constitute authority supporting respondent's right to urge in this court the affirmance of the judgment of the Circuit Court of Appeals upon a ground which the latter court rejected.

Point V.

THE COMMISSIONER'S CONTENTION THAT THIS CASE SHOULD NOW BE REMANDED TO THE BOARD OF TAX APPEALS, FOR A NEW HEARING AND NEW DETERMINATION WITH RESPECT TO THE APPLICATION OF SECTION 115(G) OF THE REVENUE ACT OF 1928, SHOULD BE OVERRULED.

Section 115(g) of the Revenue Act of 1928 provides that if a corporation cancels or redeems its stock, including stock issued as a stock dividend, at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount so distributed in *redemption or cancellation* (meaning the amount paid out by the corporation in exchange for the shares redeemed) shall be treated as a taxable dividend. The question of whether this section of the statute ought to be applied in the present case, as has already been shown, was raised by the pleadings before the Board and was the one issue covered by the evidence taken and by the stipulation of facts and by the arguments before the Board. A memorandum

opinion was filed by Division 16 of the Board (R. 14-21) on June 29, 1933, whereby it was held (R. 21):

> "The company did not cancel or redeem in the year 1929 preferred stock issued by it as a stock dividend to the petitioners" (meaning the respondent taxpayer and other petitioning taxpayers) "at such time and in such manner as to make the distribution and cancellation in whole or in part essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115(g)." The words "dividend within the" were erroneously omitted from the printed record.

The memeorandum opinion of Division 16 of the Board was the "report" of the Division. Section 601 of the Revenue Act of 1928, amending Section 906(b) of the Revenue Act of 1924, provided that:

> "The report of the division shall become the report of the Board within thirty days after such report by the division, uneless, within such period, the chairman has directed that such report shall be reviewed by the Board."

In the present case, the report of the division became the report of the Board within thirty days after June 29, 1933, because the chairman did not within that time direct that the division's report be reviewed by the Board. On the contrary, review by the Board was denied by order of the chairman dated July 24, 1933 (R. 25).

The commissioner's contention that the report of the division never became a part of the record is untenable. It is in cases where the chairman directs that the report of the division *shall* be reviewed by the Board that the statute makes the report of the division no part of the record. (Section 601 of the Revenue Act of 1928, amending Section 906(b) of the Revenue Act of 1924).

The Commissioner moved for reconsideration, after the filing of the memorandum opinion on June 29, 1933, on the sole ground that the opinion was in conflict with *Tillotson Mfg. Co.* v. *Commissioner,* 27 B. T. A. 913, decided by the

Board on March 11, 1933 (R. 22). The Commissioner's motion did not indicate any dissent from the decision in favor of the taxpayer on the original issue, viz.: whether the taxpayer had had taxable income under Section 115(g) of the statute.

The Board had held in the *Tillotson* case that the distribution of a dividend in common stock to holders of preferred stock produced taxable income. The Commissioner's motion for reconsideration on this ground was denied by order of a member of the Board entered January 15, 1934 (R. 25), and it was this order denying reconsideration that was ultimately reviewed by the Board, and vacated (R. 28). The Board then proceeded to consider the matter further, and decided that even though there was no taxable income resulting from any redemption of stock on October 1, 1929, there was taxable income under the rule of the *Tillotson* case resulting from the taxpayer's receipt of the dividend shares on July 1, 1929 (R. 30-35).

The decision that there was no taxable income under the provisions of Section 115(g) of the statute stands as the decision of the Board and as a part of the record. The Commissioner has never appealed from that decision nor assigned error on it. Article 629 of Regulations 74, dealing with the application of Section 115(g) of the 1928 Act, provided:

> "The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case."

The circumstances of this case were brought out in the evidence taken and the stipulation of facts entered into, upon hearing before the Board. When the Commissioner now argues that the case ought to be remanded to the Board of Tax Appeals, for a further hearing on the question of

the applicability of Section 115(g) of the 1928 Act, he asks in effect for a new trial of a factual issue, but without assignment of any error in the first trial.

The first opinion of the Board in this case was a finding of fact, supported by substantial evidence. The Commissioner never asserted before the Board or before the Circuit Court of Appeals that this finding of fact was *not* supported by evidence. Therefore the finding will not be reviewed or reversed by this court.

> *Helvering* v. *Tex-Penn Oil Co.*, decided by this court March 29, 1937; reported in "Advance Opinions", of Lawyers' Co-Op. Pub. Co., Volume 81, pp. 538-539.

The court will not substitute its judgment on facts for that of the Board. It is the function of the Board to weigh the evidence and declare the result. The Board having done this in the instant case, and having found on sufficient evidence that the taxpayer had no taxable income under the provisions of Section 115(g) of the statute, the result must stand.

> *Elmhurst Cemetery Co.* v. *Commissioner*, decided by this court February 1, 1937; reported in "Advance Opinions" of Lawyers' Co-Op. Pub. Co., Volume 81, p. 300.

In cases of this kind, the function of the Circuit Court of Appeals is to decide whether the correct rule of law was applied to the facts found by the Board, and whether there was substantial evidence before the Board to support the findings made.

> *Helvering* v. *Rankin*, 295 U. S. 123, 131.

Since the issue of a taxable income under Section 115(g) of the statute was not presented to the Circuit Court of

Appeals, it cannot be considered an issue in this court; and the Commissioner's motion for a new trial on that issue should be overruled.

Bank of Arizona v. *Thomas Haverty Co.*, 232 U. S. 106, 110.

Magruder v. *Drury*, 235 U. S. 106, 113.

Ana Maria Sugar Co. v. *Quinones*, 254 U. S. 245, 251.

White River Lumber Co. v. *State ex rel. Applegate*, 279 U. S. 692, 700.

Burnet v. *Commonwealth Imp. Co.*, 287 U. S. 415, 418.

Pacific States Box & Basket Co. v. *White*, 296 U. S. 176, 186.

Helvering v. *Minnesota Tea Co.*, 296 U. S. 378, 380.

Conclusion.

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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Attorney for Respondent,
Manitowoc Savings Bank Bldg.,
Manitowoc, Wisconsin.

A. L. Nash,
John C. Altman,
Of Counsel.

October 14, 1937.

APPENDIX.

STATUTES, REGULATIONS AND TREASURY DEPARTMENT DECISIONS INVOLVED.

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 113. *Basis for determining gain or loss.*

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(2) *Gift after December 31, 1920.*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) *Transfer in Trust after December 31, 1920.*—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made;

(4) *Gift or Transfer in Trust Before January 1, 1921.*—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time

of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in section 402 (e) of the Revenue Act of 1921, or in section 302 (f) of the Revenue Act of 1924 or the Revenue Act of 1926 (relating to property passing under power of appointment) regardless of the time of acquisition;

(5) *Property Transmitted at Death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death.

Sec. 115. *Distributions by Corporation.*

(a) *Definition of dividends.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

* * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or

redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

Sec. 601. *Board of Tax Appeals—Procedure.*

Sections 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

"Sec. 906. (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board."

* * * * *

Treasury Regulations 74, relating to the Revenue Act of 1928:

Art. 58. *Sale of stock and rights.*—* * * In the case of stock in respect of which any stock divided was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in Article 600. * * *

Art. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112(g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

* * * * *

Art. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which

it is issued, shall be determined as provided in articles 561 and 600.

Treasury Decision 3052, 3 C. B. 38 (August 4, 1920):

"The following applications of the decision of the Supreme Court of the United States in the case of *Eisner* v. *Macomber* in the determination of the taxability of dividends declared by corporation are published for the information and guidance of internal revenue officers and others concerned:

"1. Where a corporation, being authorized so to do by the laws of the State in which it is incorporated, transfers a portion of its surplus to capital account, issues new stock representing the amount of the surplus so transferred, and distributes the stock so issued to its stockholders, such stock is not income to the stockholders, and the stockholders incur no liability for income tax by reason of its receipt".

* * * * *

Treasury Decision 3059, 3 C. B. 38 (August 16, 1920):

"2. Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid, the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock shall be divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class."

* * * * *

Office Decision 801, 4 C. B. 24 (January-June, 1921) (extract):

"A stock dividend paid in true preferred stock is exempt from tax the same as though the dividend were paid in common stock".

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IN THE

Supreme Court of the United States

October Term, 1936

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

H. C. GOWRAN.

AMICUS CURIAE BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

ROGER S. BALDWIN,
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IN THE

Supreme Court of the United States

October Term, 1936

No. 887

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

H. C. GOWRAN.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

MOTION FOR LEAVE TO FILE A BRIEF AS *AMICUS CURIAE* IN OPPOSITION.

Now comes Roger S. Baldwin, attorney and counsellor of this Court, and represents that there are involved in this case questions which vitally affect the interests of four of his clients, who are now in controversy with the Treasury Department as to whether or not certain stock dividends received by them are subject to income tax; and, if not so subject to income tax, as to what is the cost basis of the dividend stock and whether Section 115 (g) of the Revenue Act applies to the sale of such stock dividends to the cor-

poration which paid them. The final decision in this case may determine the question of the tax liability of such four Taxpayers.

The Solicitor General, on behalf of the Petitioner, and the attorney for the Respondent Taxpayer have consented to the filing by the undersigned of an *Amicus Curiae* brief herein.

Therefore, he prays leave as *Amicus Curiae* to file the brief submitted herewith in opposition to the Petition for a Writ of Certiorari herein.

BRIEF *AMICUS CURIAE.*

Opinions Below.

The opinion of the Board of Tax Appeals (R. 39) is reported in 32 B. T. A. 820; the opinion of the Circuit Court of Appeals for the Seventh Circuit is reported in 87 Fed. (2d) 125.

Questions Presented.

I. Is a dividend by a corporation in its own Preferred Stock, paid to holders of Common Stock when there were other shares of Preferred Stock of the same classification outstanding a part of which were held by others than the common stockholders, a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928?

II. Is such a Preferred Stock Dividend taxable under the Sixteenth Amendment to the Constitution?

III. What is the correct cost basis of a Preferred Stock Dividend paid on Common Stock, assuming that such dividend was not subject to tax under the Statute at the time of its receipt?

IV. Whether this case should be remanded to the Board of Tax Appeals for determination with respect to the applicability of Section 115 (g), relating to the redemption of stock under such circumstances that it should be treated as equivalent to the distribution of a taxable dividend?

Statutes Involved.

The Statutes involved are contained in the Appendix.

Statement.

This controversy arises out of a proposed deficiency in Federal income tax of the Responding Taxpayer for the year 1929.

On June 29, 1929, the Hamilton Manufacturing Company, a Wisconsin corporation, declared a dividend on all of its outstanding common stock to the holders thereof of record on July 1, 1929. The dividend amounted to $14 per share, payable in non-voting preferred stock of the Company (R. 13, 42).

Prior to July 1, 1929, there were outstanding 7,155 shares of preferred stock of the Company, held by approximately 300 individual stockholders, none of which was held by the Taxpayer.

On July 1, 1929, there was common stock of the Company outstanding amounting to 18,680.08 shares held by 30 individuals.

On July 1, 1929, the Company's earned surplus available for distribution was not less than $444,147.05. There then remained unissued $261,600 par value preferred stock available for issue by way of stock dividend. The amount of such stock called for by the dividend of July 1, 1929 was $261,531.20 (R. 42).

The Taxpayer received as his share of the preferred stock dividend declared on July 1, 1929, 533.715 preferred shares (R. 16, 42). The preferred stock so received by the Taxpayer had a fair market value of $100 per share when received (R. 43).

On or about October 1, 1929, the Taxpayer sold all of the preferred stock so received by him as a dividend to the Hamilton Manufacturing Company, such sale being at par, *i. e.*, $100 a share (R. 43).

The Board of Tax Appeals originally decided that the sale by the Taxpayer of the preferred stock received by him as a dividend was not made under such circumstances as to make the transaction equivalent to the distribution of a taxable dividend (R. 18-28). In a later opinion the Board held that the stock dividend in question, paid in preferred stock to holders of common stock, was not a tax free stock dividend (R. 39).

The Taxpayer appealed to the Court below which decided that the stock dividend in question, while constituting income under the Sixteenth Amendment, was not subject to tax under Section 115 (f) of the Revenue Act of 1928. With respect to the cost basis of the dividend stock, the Court decided that it was the value of the stock at the time the Taxpayer received the stock dividend and not zero, as contended by the Government.

Reason for Not Granting the Writ.

The questions presented do not warrant further consideration by this Court.

Argument on Questions Presented.

I.

Is a dividend by a corporation in its own Preferred Stock, paid to holders of Common Stock when there were other shares of Preferred Stock of the same classification outstanding a part of which were held by others than the common stockholders, a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928?

Section 115 (f) of the Revenue Act of 1928 provides:

"A stock dividend shall not be subject to tax."

The question here presented involves the construction of the above quoted Section. It was determined in the negative and in favor of the taxpayers by the Circuit Court of Appeals for the Seventh Circuit in this case, decided December 22, 1936, and by the Circuit Court of Appeals for the Second Circuit in the case of *Pfeiffer* v. *Commissioner,* decided February 15, 1937 (88 Fed. (2) 3) in which we are attorney of record. In the latter case, a Petition for a Writ of Certiorari to this Court was also filed by the Government on April 15, 1937. It is assumed that such Petition will be considered at the same time as the Petition in this case.

As we will file a brief in opposition to the Petition for a Writ of Certiorari in the *Pfeiffer* case, in which we will discuss this question, we refrain from discussing it here at length. We respectfully refer the Court to our brief filed in the *Pfeiffer* case, so far as such question is concerned.

It might, however, be here stated that there has been no conflict in the Circuit Courts of Appeals on this question, in any case where the Government was attempting to tax stock dividends as income, and certainly not since the decision of the Supreme Court in the case of *Koshland* v. *Helvering,* 298 U. S. 441, in which this Court refrained from deciding such question, but clearly seemed to indicate its opinion that all stock dividends, meaning those paid in stock of the paying corporation, are exempt from taxation under the applicable Statutes.

These decisions on this question conform to an apparent Legislative and Administrative policy of so many years' standing that there is no reason why this Court should be asked to review or change it.

The Government itself, before the Board of Tax Appeals, the Circuit Courts of Appeals, and this Court, uniformly and continuously has maintained and argued (ex-

cept in these two most recent cases of *Gowran* and *Pfeiffer*) that stock dividends under the Statute were *not* subject to taxation. There is nothing in the *Koshland* decision requiring a reversal of position by the Government, or the infliction of such tremendous hardships upon taxpayers as would result from the reversal of its long established administrative policy, upon which taxpayers have relied, and according to which taxpayers have shaped their corporate financial policies for fourteen years.

There is no Constitutional question involved in this question.

II.

Is such a Preferred Stock Dividend Taxable under the Sixteenth Amendment to the Constitution?

The Circuit Court of Appeals for the Seventh Circuit apparently assumed that, by reason of the decision of the Supreme Court in the *Koshland* case, the stock dividend here under discussion must be held to be income which Congress, under the Constitution, might tax.

If this Court agrees with the Circuit Court of Appeals that a stock dividend is not taxable as income under the Statutes, the taxability of such income under the Constitution need not be decided here, at least so far as concerns the taxability of the stock dividend distribution. If, however, this Court should not agree with the Circuit Court of Appeals that a stock dividend is not taxable under the Statute, then the question of taxability under the Constitution would be an issue and should be argued before this Court.

A dividend of Prefetred Stock on Common Stock, such as was paid in this case, presents a very different situation

from that which existed in the *Koshland* case, where there was a dividend of Common Stock paid upon Preferred Stock. It would not seem, however, that this question should be argued on this application

III.

What is the correct cost basis of a Preferred Stock Dividend paid on Common Stock, assuming that such dividend was not subject to tax under the statute at the time of its receipt?

This is the main question toward which this brief is directed.

1. The Government maintains in its brief, as an alternative argument, that, if the Preferred Stock in question was not subject to tax under the Statute at the time of its receipt, such stock had a basis of *zero* for determining gain or loss from the sale or other disposition thereof, with the result that the entire proceeds from the sale would constitute taxable gain. The Government maintains that the decision of the Supreme Court in the *Koshland* case supports such conclusion. We find nothing in the *Koshland* case to that effect.

This Court in the *Koshland* case, as we read its opinion, held that the statutory basis of the stock *on which the dividend was paid* was its actual "cost" and that the Treasury Regulations requiring the apportionment of this "cost" between the old and the new stock were invalid, because of the express provisions of the Statute to the effect that the basis shall be cost.

As we read such opinion, a taxpayer who has received a *stock dividend which constitutes "income" under the*

Constitution, regardless of whether or not Congress taxed this dividend *at the time of its receipt,* is entitled to take as his basis for the dividend stock its fair market value as of the date of its receipt. This conclusion would seem to follow necessarily from the reasoning of the Court that a stock dividend which has the effect of changing the relative interests of the stockholders represents a segregation of "income" from "capital". This segregation, necessarily, creates a new basis for the stock dividend. Accordingly, if the stock dividend in the case at bar constituted "income" within the meaning of the *Koshland* decision, it follows that, except for the statutory exemption, the dividend would have been taxable as "income" and there can be no doubt but that the amount of "income" would be the fair market value of the dividend stock.

It seems equally clear that in such event, when the stock was sold or redeemed, its statutory basis was not *zero,* but its fair market value when received.

Under the *Koshland* decision, the situation is analogous, if not identical, to that in which a corporation distributes dividends in the form of property. In such a case, the taxpayer is entitled to take as his statutory basis the fair market value of the subject of the dividend (*Edwin D. Metcalf,* 13 B. T. A. 236, aff'd. 32 Fed. (2d) 192; *Daisy M. Ward,* 29 B. T. A. 1251; *Ramapo, Inc.* v. *Commissioner,* 84 Fed. (2d) 986). The shares of stock which were sold or redeemed in this case had not been purchased by the Taxpayer, but had been received by him as a stock dividend and, therefore, did not have a "cost", as the term "cost" is conventionally used. Having no "cost", the Statute providing that "cost" shall be the basis does not apply and a different rule to determine their basis must be used.

It has been uniformly held by this Court, the Circuit Courts of Appeals and the Board of Tax Appeals that where property does not have a "cost", in the conventional sense, and the applicable Revenue Act does not prescribe otherwise, its basis is the fair market value of the property at the time of acquisition by the taxpayer. (*Heiner* v. *Tindle*, 276 U. S. 582; *Rice* v. *Eisner*, 16 Fed. (2d) 358, Cert. Den. 273 U. S. 764; *Helvering* v. *Salvage*, 297 U. S. 106; *Lucas* v. *Daniel*, 45 Fed. (2d) 58; *Bankers Trust Company*, 24 B. T. A. 10; *Francis Francis*, 15 B. T. A. 1332). The fact that no tax was paid upon the receipt of the property is immaterial. (*Helvering* v. *Salvage, supra*).

If the dividend stock received by the Taxpayer in this case constituted "income" when received, then under the cases cited above it is clear that the cost basis of such dividend stock is its fair market value when received and not zero as claimed by the Government.

If, on the other hand, the stock dividend did not result in the distribution or receipt of "income" within the meaning of the Sixteenth Amendment, but resulted in a mere split-up of the shares representing the capital investment, then neither in the *Koshland* case nor in any other Court or Board Decision has there been any doubt cast upon the propriety or validity of the Regulations requiring an adjustment of the cost between the original shares and the new shares issued as a stock dividend.

As an instance where the basis of property received as a dividend is its fair market value at the date of receipt, although the dividend is not taxable, take the case of a distribution out of earnings and profits accumulated prior to February 28, 1913 (Section 115 (a), Revenue Act of 1928). Another instance of this character would be where a domestic dividend is received by a corporate shareholder (Sec. 23 (p) (1), Revenue Act of 1928).

It would be interesting to apply the reasoning in the *Koshland* case to a Stock Dividend, constituting income under the Sixteenth Amendment, if such dividend were received by a corporate shareholder. The dividend, being a dividend received by a corporation, would be exempt from income tax. What should be its basis, assuming that it is income within the reasoning of the *Koshland* case? If a basis of zero should be applied, as contended by the Government in this case, to such a stock dividend received by a corporation, then the corporation upon the sale of the Dividend Stock would be required to pay a tax upon the total value of the stock, thus depriving the corporation of the exemption granted by the Statute. On the other hand, if market value is applied to the Dividend Stock as a basis, there would be no tax upon the sale of the Dividend Stock unless it was sold above the price at which it was received. It is not likely that Congress intended that one basis should be applied to a corporate shareholder and another to an individual shareholder.

The Government claims that because the Taxpayer paid nothing upon the receipt of the dividend, it must be assumed that it cost him nothing and that the basis must, therefore, be zero. There is no Statute or Regulation which so provides, and no authority has been cited or is known to support this view.

2. The Government complains of the comparison, made by the Circuit Court of Appeals in its decision, of the stock dividend in this case with tax free gifts, bequests and legacies, stating that for the latter the Statute itself provides that the basis shall be the value at date of acquisition. The Government points out in its brief that in the case of a stock dividend there is no similar Statute. There is *no*

Statute to the effect that zero shall be taken as the basis of stock received as a dividend, and in the absence of such a Statute an assumption should not be made which violates the realities and is contrary to the general policy of the administration of the Income Tax Law as prescribed in the Statute in analogous situations.

Prior to the enactment of the Statute requiring a donee to use his donor's basis for determining gain or loss from the sale of the subject of the gift, the Statute was silent in regard to the basis which the donee was required to use and in such circumstances it was uniformly held that the donee was entitled to use as his basis the fair market value of the subject of the gift at the time of receipt. A specific amendment of the Statute was necessary to require the donee to use a basis other than the fair market value at the time of receipt. Although the Statute expressly provides the basis of property acquired by legacy or bequest, there is no indication in the Statutes, Regulations or Court Decisions that, in the absence of such a Statute, the recipient would be required to take any basis other than the fair market value as of the date of receipt.

Thus, we submit that the decision of the Circuit Court in this case conforms essentially to the principles of law applicable to the basis of property, other than stock dividends, acquired without an actual outlay of money or other consideration. The facts should not be tortured by assuming a basis which does not exist.

In view of the long continued practice of the Treasury Department in requiring apportionment of cost between the original stock and the dividend stock, which practice was supported by definite and specific Regulations, it is fair to assume that Congress considered this to be the established law. This Court in the *Koshland* case held that these Regu-

lations were invalid as applied to a stock which had a "cost," in that they had the effect of reducing cost by the receipt of income, and that in the absence of Statutory authority the Commissioner was without power to make such a Regulation. The acceptance of the zero basis, as urged by the Government, would result in a larger amount of income and a greater tax liability than would result under the Regulations requiring apportionment which this Court condemned in the *Koshland* case.

Congress having failed to tax stock dividends when received, whether as a legislative policy or due to an erroneous understanding of its powers, certainly it is not proper, in the absence of Statutory provisions, for the Treasury Department to tax such dividends when the dividend stock is sold, except in a case where Section 115 (g) applies. That which is "income" in the year in which it is received, cannot be "capital gain" in the year in which it is sold and cannot be taxed except by special Statutory provision.

If the Government is not satisfied with the present applicable Statutes and Regulations, or their interpretation by the Courts, it would seem as though the remedy were by Congressional Act, as was done by Section 115 (f) of the Revenue Act of 1936, with respect to the taxation of stock dividends when received. This changed the previous Revenue Acts and made stock dividends in the future taxable to the extent that they constitute "income" within the meaning of the Sixteenth Amendment to the Constitution.

IV.

Whether this case should be remanded to the Board of Tax Appeals for determination with respect to the applicability of Section 115 (g), relating to the redemption of stock under such circumstances as to make such redemption essentially equivalent to a taxable dividend?

This question, in its initial stage before the Board of Tax Appeals, was largely a question of fact, but the question, as here presented, is largely a question of procedure. These questions will not be discussed in this brief.

It might, however, be briefly stated that no important question of Federal Law is here involved and no question which would be helpful in the decision of other cases because the application of Section 115 (g) is dependent entirely upon the facts of each individual case.

Conclusion.

There is no important question of law here presented which needs further settlement by this Court.

Respectfully submitted,

ROGER S. BALDWIN,
Amicus Curiae,
120 Broadway,
New York City, New York.

Dated: April 30th, 1937.

APPENDIX.

Revenue Act of 1928:

Section 115. DISTRIBUTION BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

Section 23 (p) (1):

In computing net income there shall be allowed as deductions:

Dividends received by Corporations.—In the case of a corporation, the amount received as dividends from a domestic corporation, * * *.

Revenue Act of 1936:

Section 115 (f) (1) General Rule.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

PETITION FOR REHEARING

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

H. C. GOWRAN,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR REHEARING.

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

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H. C. GOWRAN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR REHEARING.

Comes now the above named respondent, H. C. Gowran, and presents this his petition for a rehearing of the above entitled cause, and in support thereof, respectfully shows:

The judgment of this Court was entered on December 6, 1937. The time for filing a petition for rehearing was enlarged until January 10, 1938, by an order of Mr. Justice Brandeis, dated December 28, 1937. This petition for rehearing is directed to that portion of the decision which

holds that the stock dividend received and sold by respondent Gowran had a basis of zero for the purpose of determining gain or loss.

* * * * * *

Because of the predominance of other issues in the case, Section 113 (b) (1) (D) of the 1932 and later Revenue Acts was overlooked and was not brought to the Court's attention. The effect of this Court's "zero basis" ruling, when applied together with Section 113 (b) (1) (D), is to subject Gowran to a capital levy, or if not that, then inevitably to two taxes upon the same income. Serious constitutional questions are thereby presented which have not been considered but which should be considered by this Court.

Section 113 (b) (1) (D) of the 1932, 1934 and 1936 Revenue Acts provides as follows:

> "The adjusted basis for determining gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under Subsection (a), adjusted as hereinafter provided.
>
> "(1) General rule.—Proper adjustment in respect of the property shall in all cases be made— * * *
>
> "(D) In the case of stock * * * for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis * * *"

Under Section 113 (b) (1) (D), Gowran, having received a tax-free stock dividend, is required to reduce the basis of his previously held stock by an amount equal to the value of such stock dividend at date of issue.* At the same

* Under the authority granted in the final paragraph of the opinion, Gowran is prepared, if necessary, to establish before the Board that he continued to own, until after the effective date of the 1932 Revenue Act, his original stock upon which the stock dividend was declared, so that he is subject to Section 113 (b) (1) (D). However, as the opinion now stands, it would be futile for Gowran to establish this or any other additional fact before the Board, since the "zero basis" ruling is based entirely upon the single fact that the dividend stock had no cost (in the sense of purchase price), a fact as to which, of course, no contrary showing can possibly be made.

time, his dividend stock is given a basis of zero under the decision in the case at bar. The value of the dividend stock is thus taxed twice: once when Gowran sells the previously held stock and again when he sells the dividend stock. The result is plainly a capital levy, as will appear from the following illustration:

Let us assume that in 1928 Gowran bought one share of common stock for $14.00; that in 1929 he received a stock dividend consisting of one share of preferred stock having a then value of $14.00; and that in 1932 he sold both shares. Under Section 113 (b) (1) (D), the basis of his common share would be reduced by $14.00 (the value of the stock dividend) and his common share would therefore have a basis of zero. Under the decision in the case at bar, his preferred share would also have a basis of zero. As a result, the entire proceeds from the sale of both shares would be taxed as income, and Gowran would never be permitted to recover free of tax his original capital investment of $14.00. The foregoing is obviously a capital levy rather than a tax on income.

It may be thought that Section 113 (b) (1) (D) is unconstitutional under *Koshland* v. *Helvering*, 298 U. S. 441, in which case this Court held that under the 1928 Revenue Act, the basis of previously held stock could not be reduced by reason of the payment of a stock dividend thereon. However, the *Koshland* decision rested in large part, and could have been rested altogether, upon the lack of statutory authority in the 1928 Revenue Act for such reduction of basis. Such statutory authority was supplied in Section 113 (b) (1) (D) of the 1932 and later Revenue Acts, and it appears, therefore, that the *Koshland* case does not apply to sales under the 1932 and later Revenue Acts. It may be

observed further that if the *Koshland* case should be construed as holding that Congress may not constitutionally postpone the taxing of income by means of making an adjustment in the basis of assets owned by the taxpayer, then serious doubt will be cast upon the validity of all of the reorganization provisions of the various Revenue Acts, since in such reorganization provisions Congress has repeatedly made use of an adjustment of basis as the means of postponing the tax upon income presently received.

As stated at the beginning of this petition, the necessary effect of the "zero basis" ruling in the case at bar, when applied together with Section 113 (b) (1) (D), is to subject Gowran to a tax in the nature of a capital levy; for he would pay an income tax on the entire proceeds of the dividend shares when sold, and would then pay another tax on a like amount (although not income within the meaning of the Sixteenth Amendment) on sale of his original shares. The second tax would necessarily result from the reduction of basis. If it should be held that both taxes are income taxes within the meaning of the Constitutional Amendment, then the taxpayer will be subjected to two income taxes on one income. The "zero basis" rule, as announced in this case, thus raises important questions, constitutional and otherwise, which have not been considered but which it is believed the Court will desire to consider before its decision becomes final.

* * * * * *

In connection with the "zero basis" point, the Court's attention was not called to the effect of Section 115 (f) of the 1936 Revenue Act. Under Section 115 (f) of the 1936 Revenue Act, stock dividends of the type involved in the case at bar are taxed when received, to the extent of their then market value. If such stock dividends received under

the 1936 Revenue Act are given a basis of zero, then they will be taxed twice: once when they are received and again when they are sold. Obviously Congress did not intend in the 1936 Revenue Act to impose such double tax, but on the contrary intended that such stock dividends should be given a basis consisting of their market value when received. And yet the basis provisions of the 1936 Revenue Act, in so far as here material, are identical with the basis provisions of the 1928 Revenue Act, which is involved in the case at bar. No conceivable justification can be found for holding that such identical basis provisions allow market value as the basis under the 1936 Revenue Act, while at the same time requiring a "zero basis" under the 1928 Revenue Act. Both Acts must necessarily be construed as authorizing the use of market value as the basis in the circumstances described, since any other construction raises serious constitutional questions.

In like manner, the Court's attention was not directed to the treatment which is accorded under the various Revenue Acts to dividends in property. Such dividends in property are of course taxed when received, to the extent of their then market value. It has been the universal practice on the part of both the Government and taxpayers to treat such dividends in property as having a basis equal to their market value when received. To give such dividends in property a basis of zero would be to tax such dividends twice: once when they are received and again when they are sold. And yet all of the Revenue Acts, including the 1928 Revenue Act, which is involved in the case at bar, are silent as to the basis of dividends in property, just as in the case of stock dividends they are silent as to basis. No justification can be found for holding that the 1928 Revenue Act allows market value to be used as the basis of divi-

dends in property, while at the same time requiring a basis of zero in the case of stock dividends. It is respectfully urged that as to both types of dividends, the 1928 Revenue Act must be construed as authorizing the use of market value as the basis, since any other construction necessarily raises important and difficult questions as to both the intent and the constitutional power of Congress in the premises.

The views just urged are in accordance with the principles announced by this Court in *Hartley* v. *Commissioner*, 295 U. S. 216, and *Heiner* v. *Tindle*, 276 U. S. 582, which cases are discussed at pages 33-36 of Gowran's brief.

* * * * * *

The points stated and argued above were not, it is believed, considered by the Court in making its decision in this case. They were not presented to the Court on the argument, mainly because there appeared to be other matters involved which were of greater importance, upon which both counsel for the Government and counsel for the taxpayer bestowed their principal efforts. The points raised by this petition for rehearing are, however, inherent in the case, and are questions which this Court will ultimately find it necessary to answer. While this petition for rehearing is made for the purpose of relieving respondent Gowran from the hardship created by the "zero basis" theory as applied to him, it is considered proper to mention also the very substantial public interest involved and on that account to urge that the questions presented be answered here and not be postponed for a period of time which must involve much uncertainty and confusion on the part of both the Government and the taxpayers of the country, with a great amount of litigation in the lower courts. The respondent therefore respectfully prays that this petition for

rehearing be granted and that a reargument be ordered so that the matters above referred to may be fully and properly presented to, and considered by, this Court.

Respectfully submitted,

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CERTIFICATE OF COUNSEL.

I, A. L. Nash, counsel for the above named petitioner, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

A. L. NASH,
Counsel for H. C. Gowran.

SUPREME COURT OF THE UNITED STATES.

No. 27.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* H. C. Gowran.	On Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[December 6, 1937.]

Mr. Justice Brandeis delivered the opinion of the Court.

The questions for decision concern the taxation as income of a dividend in preferred stock and the proceeds received on its sale.

On June 29, 1929, the Hamilton Manufacturing Company, a Wisconsin corporation, had outstanding preferred stock of the par value of $100 a share and common stock without par value. On that day the directors declared from the surplus earnings a dividend of $14 a share on the common stock, payable on July 1, 1929, in preferred stock at its par value. Gowran, as owner of common stock, received as his dividend 533 and a fraction shares of the preferred. On or about October 1, 1929, the company acquired his preferred stock and paid him therefor, at $100 a share, $53,371.50. In his income tax return for the year Gowran did not treat this sum as taxable income, but included $27,262.72 as capital net gain on the shares received and sold, computing the gain under Articles 58 and 600 of Regulations 74, then in force. The Commissioner rejected that treatment of the matter; determined that the $53,371.50 received was income taxable under the Revenue Act of 1928, § 115 (g), 45 Stat. 791, 822, as a stock dividend redeemed; and assessed a deficiency of $5,831.67.

The taxpayer sought a redetermination by the Board of Tax Appeals. A division of the Board concluded, upon testimony and stipulated facts, that there had been no cancellation or redemption of the preferred stock so as to make it a taxable dividend under § 115 (g); that the transaction by which the company acquired it constituted a sale. The Commissioner secured a reconsideration of the case. He then contended that, under the rule declared in *Commissioner of Internal Revenue* v. *Tillotson Mfg. Co.*, 76 F. (2d) 189, the stock dividend was taxable, because it had resulted in a change

of Gowran's proportionate interest in the company. That contention was sustained by the Board; and, on that ground, it affirmed the Commissioner's determination of a deficiency. 32 B. T. A. 820.

The taxpayer sought a review by the Circuit Court of Appeals. The Commissioner again urged that the stock dividend was taxable; and then, for the first time, contended that, even if it was not taxable, the determination of the deficiency should be affirmed, because within the tax year the stock had been sold at its par value and, as its cost had been zero, the entire proceeds constituted income. The Court of Appeals recognized that, since the dividends in preferred stock gave to Gowran an interest different in character from that which his common stock represented, it was constitutionally taxable under *Koshland* v. *Helvering,* 298 U. S. 411; but it held that the dividend could not be taxed as income, since by § 115 (f) Congress had provided: "A stock dividend shall not be subject to tax". And it held further that no part of the proceeds could be taxed as income, since there was no profit on the sale, it being agreed that the fair market value of the stock, both at the date of receipt and at the date of the sale, was $100 a share. 87 F. (2d) 125.

Because of the importance of the questions presented in the administration of the revenue laws, certiorari was granted. 301 U. S. —.

First. The Government contends that § 115 (f) should be read as prohibiting taxation only of those stock dividends which the Constitution does not permit to be taxed; and that, since by the dividend Gowran acquired an interest in the corporation essentially different from that theretofore represented by his common stock, the dividend was taxable. In support of that construction of § 115 (f), it is urged that Congress has in income tax legislation manifested generally its intention to use, to the full extent, its constitutional power, *Helvering* v. *Stockholms Bank,* 293 U. S. 84, 89; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; that this Court holds grants of immunity from taxation should always be strictly construed, *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491; and that the only reason for exempting stock dividends was to comply with the Constitution.

This preferred stock had substantially the same attributes as that involved in the *Koshland* case. There the dividend was of common stock to a preferred stockholder, it is true; but we are of opinion that under the rule there declared Congress could have taxed this

stock dividend. Nevertheless, by § 115 (f) it enacted in 1928, as it did in earlier and later Revenue Acts, that "a stock dividend shall not be subject to tax." The prohibition is comprehensive. It is so clearly expressed as to leave no room for construction. It extends to all stock dividends. Such was the construction consistently given to it by the Treasury Department.[1] The purpose of Congress when enacting § 115 (f) may have been merely to comply with the requirement of the Constitution as interpreted in *Eisner* v. *Macomber*, 252 U. S. 189; and the comprehensive language in § 115 (f) may have been adopted in the erroneous belief that under the rule declared in that case no stock dividend could be taxed. But such facts would not justify the Court in departing from the unmistakable command embodied in the statute. Congress declared that the preferred stock should not be taxed as a dividend.

Second. The Government contends that, even if § 115 (f) be construed as prohibiting taxation of the preferred stock dividend, the decision of the Board of Tax Appeals affirming the Commissioner's determination of a deficiency should be sustained, because the gain from sale of the stock within the year was taxable income and the entire proceeds must be deemed income, since the stock had cost Gowran nothing. The Circuit Court of Appeals rejected that contention. It held that there was no income, because, as stipulated, there was no difference between the value of the stock when received

[1] Eisner *v.* Macomber was decided March 8, 1920. Soon thereafter, the Treasury Department declared, in a series of Decisions and Regulations, that no stock dividend was taxable. Treas. Dec. 3052, 3 C. B. 38 (August 4, 1920); Treas. Dec. 3059, 3 C. B. 38 (August 16, 1920); Office Dec. 732, 3 C. B. 39 (October 28, 1920). Office Dec. 801, 4 C. B. 24 (January 5, 1921) provided: "A stock dividend paid in true preferred stock is exempt from the tax the same as though the dividend were paid in common stock." Then followed legislation in the precise form embodied in § 115 (f) of the Revenue Act of 1928. See § 201 (d) of the Revenue Act of 1921, 42 Stat. 227, 228; § 201 (f) of the Revenue Act of 1924, 43 Stat. 253, 255; § 201 (f) of the Revenue Act of 1926, 44 Stat. 9, 11; §115 (f) of the Revenue Act of 1932, 47 Stat. 169, 204; § 115 (f) of the Revenue Act of 1934, 48 Stat. 680, 712. Article 628 of the Regulations in force in 1928 provided: "Stock dividends.—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in Articles 561 and 600."

Koshland *v.* Helvering, 298 U. S. 441, was decided May 18, 1936. On June 22, 1936, Congress, in enacting the Revenue Act of 1936, provided in § 115 (f): "1. General Rule—A distribution made by a corporation to its stockholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholders within the meaning of the Sixteenth Amendment to the Constitution." 49 Stat. 1648, 1688. See also § 115 (h).

and its value when sold. The court likened a non-taxable stock dividend to a tax-free gift or legacy and said: "One who receives a tax-free gift and later sells it, in the absence of statute providing otherwise, is taxed upon the profit arising from the difference in its value at the time he receives it and the sale price. Similarly one who receives a tax-free bequest, when selling it, is taxed upon the profit arising from any excess of the sale price over its fair market value at the time of receipt." Compare *Taft* v. *Bowers*, 278 U. S. 470.

The cases are not analogous. Unlike earlier legislation, Section 113 (a) (2) of the Revenue Act of 1928 prescribes specifically the basis for determining the gain on tax-free gifts and legacies. It provides that: "If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceeding owner by whom it was not acquired by gift." And the basis for the computation on property transmitted at death is provided for in paragraph (5). But the method of computing the income from the sale of stock dividends constitutionally taxable is not specifically provided for. Furthermore, unlike Section 22 (b) (3), excluding from gross income the value of gifts and legacies, Section 115 (f) cannot, in view of its history, be taken as a declaration of Congressional intent that the value of all stock dividends shall be immune from tax not only when received but also when converted into money or other property. Gain on them is, therefore, to be computed as provided in §§ 111 and 113, by the "excess of the amount realized" over "the cost of such property" to the taxpayer. As the cost of the preferred stock to Gowran was zero, the whole of the proceeds is taxable.

Gowran asserts that if this "basis of zero" theory is accepted, the proceeds are taxable not as determined by the Commissioner but as a capital gain at a different rate and under different regulations. This depends upon whether the preferred stock received as a dividend was a "capital asset", defined by Section 101 (c) (8) as "property held by the taxpayer for more than two years". The record is silent as to when Gowran acquired the common stock upon which the preferred was issued as a dividend, but it may be assumed that he had held it for more than two years. For that fact is immaterial since the dividend stock had been held for only three months. Whether taxed by Congress or not, it was income, substantially equivalent for income tax purposes to cash or property,

and under Section 115 (b) was presumed to have been made "out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits". In no sense, therefore, can it be said to have been "held" by Gowran prior to its declaration.[2] Since the proceeds were therefore not "capital gains", they were taxable at the normal and surtax rates applicable to ordinary income.[3]

Third. Gowran contends here that the Government should not have been permitted by the Court of Appeals to argue its "basis of zero" theory, because that theory raised an issue not pleaded, tried, argued or otherwise referred to in the proceedings before the Board. It is true that the theory was first presented by the Commissioner in the Court of Appeals. But it does not appear by the record that objection to the consideration of this theory was made below. The only objection made there, as disclosed by the opinion, was "that the Board was without jurisdiction to decide the case upon a point not urged by the commissioner." As to that objection, the court, after stating that the only questions submitted are those of law, said: "The Board approved the commissioner's assessment, but did so upon a legal theory different from his. We are of opinion that the Board acted within its powers. . . . It is immaterial whether the commissioner proceeded upon the wrong theory. The burden is upon the petitioner to show that the assessment is wrong upon any proper theory; otherwise he must fail."

In the review of judicial proceedings the rule is settled that if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason. *Frey & Son, Inc.* v. *Cudahy Packing Co.*, 256 U. S. 208; *United States* v. *American Ry. Exp. Co.*, 265 U. S. 425; *United States* v. *Holt State Bank*, 270 U. S. 49, 56; *Langnes* v. *Green*, 282 U. S. 531; *Stelos Co.* v. *Hosiery Motor-Mend Corp.*, 295 U. S. 237, 239; cf. *United States*

[2] Article 501 of Regulations 74 states that "if the taxpayer has held for more than two years stock upon which a stock dividend has been declared, both the original and dividend shares are considered to be capital assets". But this was based upon the erroneous premise that stock dividends could not be income, and was part of an administrative scheme to apportion some of the cost of the original shares to the stock received by way of dividend. This arrangement we declared in Koshland *v.* Helvering, 298 U. S. 441, to be without statutory authority, and the same must be said of the Regulation involved here.

[3] See Burnet *v.* Harmel, 287 U. S. 103, 105-106; Helvering *v.* New York Trust Co., 292 U. S. 455, 463; McFeely *v.* Commissioner, 296 U. S. 102, 106-107.

v. *Williams*, 278 U. S. 255. This applies also to the review of decisions of the Board of Tax Appeals. *Helvering* v. *Rankin*, 295 U. S. 123, 132-33; cf. *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206.[4] The taxpayer sought review of the Board's decision by the Court of Appeals. The ultimate question before that court was whether, upon the facts stipulated, the Board had erred in affirming the Commissioner's determination that the additional taxes were due. If the Commissioner was right in his determination, the Board properly affirmed it, even if the reasons which he had assigned were wrong.[5] And, likewise, if the Commissioner's determination was right, the Board's affirmance of it should have been sustained by the Court of Appeals, even if the Board gave a wrong reason for its action. By this rule the Government was entitled to urge in the Court of Appeals that on the undisputed facts the Board's decision was correct because of the "basis of zero" theory. And since that court rejected the theory, the Government was entitled to assert its contention here. Nothing in *General Utilities & Operating Co.* v. *Helvering, supra*, or in *Helvering* v. *Salvage*, 297 U. S. 106, is opposed to such procedure.

If the Court of Appeals had accepted the theory, it would have been open to the taxpayer to urge, in view of the new issue presented that he should have the opportunity to establish before the Board additional facts which would affect the result.[6] As we accept the new theory, leave is granted Gowran to apply to the lower court for that purpose.

Reversed.

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[4] See also Hurwitz *v.* Commissioner, 45 F. (2d) 780 (C. C. A. 2); Superheater Co. *v.* Commissioner, 38 F. (2d) 69 (C. C. A. 2); Commissioner *v.* Linderman, 84 F. (2d) 727 (C. C. A. 3); Dickey *v.* Burnet, 56 F. (2d) 917 (C. C. A. 8); Lewis-Hall Iron Works *v.* Blair, 23 F. (2d) 972 (App. D. C.); cf. Dobbins *v.* Commissioner, 31 F. (2d) 935 (C. C. A. 3); Seufert Bros. Co. *v.* Lucas, 44 F. (2d) 528 (C. C. A. 9); Hughes *v* Commissioner, 38 F. (2d) 755 (C. C. A. 10).

[5] Compare Darcy *v.* Commissioner, 66 F. (2d) 581 (C. C. A. 2); Helvering *v.* Gregory, 69 F. (2d) 809 (C. C. A. 2), aff'd, 293 U. S. 465; Alexander Sprunt & Son, Inc. *v.* Commissioner, 64 F. (2d) 424 (C. C. A. 4); Helvering *v.* Bowen, 85 F. (2d) 926 (C. C. A. 4); Atlanta Casket Co. *v.* Rose, 22 F. (2d) 800 (C. C. A. 5); J. & O. Altschul Tobacco Co. *v.* Commissioner, 42 F. (2d) 609 (C. C. A. 5); Crowell *v.* Commissioner, 62 F. (2d) 51 (C. C. A. 6); Schweitzer *v.* Commissioner, 75 F. (2d) 702 (C. C. A. 7), rev'd on other grounds, 296 U. S. 551; Christopher *v.* Burnet, 55 F. (2d) 527 (App. D. C.); Beaumont *v.* Helvering, 73 F. (2d) 110 (App. D. C.).

[6] Compare Woodward *v.* Boston Lasting Machine Co., 60 Fed. 283, 63 Fed. 609 (C. C. A. 1).